Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554



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| In the Matter of | ) | |
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| Petition of Ameritech for Forbearance from | ) | |
| Dominant Carrier Regulation of its | ) | CC Docket No. 99-65 |
| Provision of High Capacity Services in the | ) | |
| Chicago LATA | ) | |

# PETITION OF AMERITECH FOR FORBEARANCE FROM DOMINANT CARRIER REGULATION OF ITS PROVISION OF HIGH CAPACITY SERVICES IN THE CHICAGO LATA

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## SUMMARY

Ameritech, pursuant to Section 10 of the Telecommunications Act of 1996 ("1996 Act"), hereby requests that the Commission forbear from regulating Ameritech as a dominant carrier in the provision of high capacity special access and dedicated transport for switched access in the Chicago local access and transport area.

In this petition, Ameritech demonstrates that the Chicago area market for high capacity services is robustly competitive. The numerous competitive providers of high capacity services include established facilities-based competitors, such as ATT/TCG and MCI/MFS/WorldCom, with extensive fiber networks and access to substantial financial resources with which to fund expansion of these networks. Moreover, Ameritech has virtually no retail presence in this market any longer.

In her report, economist Dr. Debra J. Aron of the Law and Economics Consulting Group concludes that Ameritech lacks market power in the Chicago area market for high capacity services. In other words, the state of competition is such that the requirements of Section 10 have been met and the Commission should forbear from dominant carrier regulation of Ameritech's provision of high capacity services in Chicago.

Under the criteria used by the Commission previously, Ameritech's provision of high capacity services in Chicago qualifies for non-dominant treatment. First, as noted in Dr. Aron's report, Ameritech has a miniscule 6% of the retail high capacity (special access) market while competitive providers have captured a significant

portion of the market for dedicated transport services.

Second, there is high demand elasticity. The customers that purchase high capacity services – medium to large businesses, governmental entities, and especially large interexchange carriers ("IXCs") – are highly sensitive to price and other service characteristics. The ability of Ameritech's largest carrier customers to migrate high capacity traffic to their own affiliated fiber networks further increases their bargaining ability. These customers have no particular "brand loyalty" and will not hesitate to switch large volumes of business between carriers if they can obtain a better bargain in the process.

Third, there is high supply elasticity. Competitors have extended their facilities nearly ubiquitously throughout the areas where demand for high capacity services exists. Competitive providers have deployed more than 1300 route miles of optical fiber in the Chicago LATA. These extensive fiber backbone networks have more than sufficient capacity to handle all of Ameritech's end user and transport traffic in the LATA. In fact, these facilities are located in wire centers representing 87% of Ameritech's high capacity service revenues and 94% of Ameritech's special access local distribution channels ("LDCs") in the LATA. In addition, the impressive increase of competitive providers' share of market growth demonstrates that the cost of entry and expansion is not prohibitive.

Fourth, Ameritech does not enjoy any unfair advantage in terms of its costs, structure, size and resources. Indeed, the combined A&T/TCG and MCI/MFS WorldCom companies have a significant advantage in terms of scale economies and access to capital, as well as the advantage of being able to provide a complete package of services -- including interLATA services -- to their customers.

In light of Ameritech's lack of market power, Dr. Aron concludes that competition, without dominant carrier regulation, is sufficient to constrain any ability that Ameritech otherwise might have had to impose unjust or unreasonable prices or other terms and conditions of service. Therefore, Ameritech seeks forbearance from dominant carrier regulation of its provision of high capacity services in the Chicago LATA, including the requirement that it file tariffs on up to 15-days' notice with cost support, price regulation, and the requirement that it charge averaged rates throughout the Illinois study area.

The Commission should grant Ameritech's request because it satisfies the three criteria of Section 10. First, because Ameritech lacks market power, dominant carrier regulation is not necessary to ensure that its rates and practices are just, reasonable and not unreasonably discriminatory. Moreover, other regulations (such as Sections 201 and 202 of the Communications Act of 1934, as amended) are sufficient to ensure that Ameritech does not act unreasonably. Second, for these same reasons, dominant carrier regulation is not necessary to protect consumers. Third, forbearance from applying dominant carrier regulation to Ameritech's provision of high capacity services is consistent with the public interest because it will intensify competitive activity, thus benefiting customers.

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PETITION OF AMERITECH FOR FORBEARANCE FROM DOMINANT CARRIER REGULATION OF ITS PROVISION OF HIGH CAPACITY SERVICES IN THE CHICAGO LATA

Ameritech,[1] pursuant to Section 10 of the Telecommunications Act of 1996 ("1996 Act"),[2] hereby requests that the Commission forbear from regulating Ameritech as a dominant carrier in the provision of high capacity special access, dedicated transport for switched access, and interstate intraLATA private line (point-to-point) services ("high capacity services")[3] in the Chicago, Illinois, local access and transport area ("LATA"). This includes forbearance from enforcing the Commission's Part 61 tariff rules as they apply to dominant carriers and any other rules affecting high capacity services which result in different regulatory treatment for Ameritech vis-à-vis non-dominant carriers.

This petition is limited in scope both geographically and with respect to the

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[1] Ameritech means Ameritech Illinois, Ameritech Indiana, Ameritech Michigan, Ameritech Ohio, and Ameritech Wisconsin.

[2] 47 U.S.C. § 160.

[3] Specifically, Ameritech seeks regulatory relief for special access and dedicated transport for switched access and interstate intraLATA private line (point-to-point) services at DS1 and higher transmission levels (e.g., DS1, DS3 and OC-n).

services covered by it. Furthermore, it does not present any novel questions of law or fact which might prolong the Commission's analysis. Therefore, Ameritech also requests that the Commission rule on this petition expeditiously in order to bring the full benefits of competition to customers in the Chicago area as soon as possible.[4]

## I. INTRODUCTION

Section 10 is one of the key pro-competitive provisions Congress included in the 1996 Act. It requires the Commission to forbear from applying any regulation or provision of the Act if the Commission determines that: (1) enforcement is not necessary to ensure that rates and practices are just, reasonable, and not unreasonably discriminatory; (2) enforcement is not necessary to protect consumers; and (3) forbearance is consistent with the public interest.[5] In making the public interest determination, Section 10 requires that the Commission consider whether forbearance will promote competitive market conditions, including the extent to which forbearance will enhance competition.[6] The statutory imperative created by Section 10 reflects Congress's reasoned judgment that competition, not government regulation, should guide companies' behavior in competitive telecommunications markets.

[4] Under Section 10, in the absence of an extension, the Commission has one year to act on a forbearance petition before it is deemed to be granted. 47 U.S.C. § 160(c).

[5] 47 U.S.C. § 160(a)(1)-(3).

[6] 47 U.S.C. § 160(b).

In this petition, Ameritech demonstrates that the market for high capacity services in Chicago LATA is vigorously competitive.[7] The significance of the competitive environment in the Chicago LATA has already been recognized by the Commission as justifying waivers of certain of its access charge rules.[8] Ameritech faces intense competition from at least three facilities-based competitors with substantial resources and extensive fiber networks. Two of these established companies – AT&T Corp., which recently acquired Teleport Communications Group, which is in the process of acquiring cable TV giant TCI, and which has just announced a massive strategic partnership with Time Warner concerning use of the Latter's extensive distribution network[9] (collectively referred to as "AT&T/TCG"), and MCI WorldCom, Inc., which includes the previously acquired facilities of MFS and Brooks Fiber ("MCI/MFS WorldCom") — have access to financial resources equal to or greater than Ameritech's with which to fund expansion of their networks.[10] Equally as important, the recently completed mergers of TCG with AT&T Corp. and MCI with MFS WorldCom, have resulted in the two largest

[7] Ameritech is not seeking this relief in the context of the Pricing Flexibility Framework that it has placed on the record with its October 26, 1998, comments updating the record in the Commission's access reform proceeding. However, the conditions in the LATA already do meet the Framework's requirements for Phase III relief for transport services. In the Chicago LATA, operational collocation arrangements exist in wire centers representing 92% (compared to the Framework's 75% requirement) of DS1 equivalents.

[8] See *In the Matter of Ameritech Operating Companies for Declaration Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region,* Order, FCC 96-58, 11 FCC Rcd. 14028 (released February 15, 1996) ("Customers First Order").

[9] See TR Daily, February 1, 1999.

[10] In addition to these fiber facilities-based competitors and NextLink with over 100 route miles of fiber in the area, several competitors (e.g., WinStar and Teligent) are using wireless technology to provide high capacity services. See Section II B.1, *infra*.

purchasers of high capacity services in Chicago (AT&T and MCI) having their own competitive fiber networks. Ameritech is already experiencing the effects of these mergers, as significant portions of these customers' high capacity services are being migrated to the IXCs' affiliated fiber networks.[11]

Ameritech's declining market share for high capacity services in the Chicago area is one fact supporting the finding that Ameritech lacks market power. The analysis conducted by economist Dr. Debra J. Aron of the Law and Economics Consulting Group[12] shows that competitive providers have captured almost 94% percent of the retail market for high capacity special access, almost half of the special access high capacity LDC facility market, and a substantial portion of the market for high capacity transport services.[13]

In her report, Dr. Aron has analyzed the market share and competitive fiber network data for the Chicago area high capacity services market She concludes that, in light of Ameritech's lack of market power, competition itself, without dominant carrier regulation, is sufficient to constrain any ability to Ameritech might have otherwise had to impose unjust or unreasonable rates or other terms and conditions of services.[14] Indeed, Dr. Aron concludes that continuing dominant

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[11] Upon completion of the AT&T/TCG merger, AT&T Chairman Michael Armstrong said "We're reducing our dependence on Bell companies for direct connections to businesses." Armstrong also pledged "substantial resources" to continue building facilities in key markets, and has mentioned $1 billion for TCG's share of continuing AT&T capital expenses. Communications Daily, July 27, 1998.

[12] "An Analysis of Market Power in the Provision of High Capacity Access in the Chicago LATA in Support of Ameritech's Petition for Section 10 Forbearance" by Dr. Debra J. Aron ("Aron Report") included as Attachment A.

[13] *Id.* at. 19-25.

[14] *Id.* at 9-11.

carrier regulation of Ameritech's high capacity services in this highly-competitive environment would itself be anti-competitive and injurious to customers.[15]

Ameritech is the only carrier in the market that is required to file tariffs on up to 15-days' notice and provide cost support.[16] Not only does this impose an unnecessary regulatory burden on Ameritech, but it gives competitive providers advance knowledge of Ameritech's rates, thereby providing these competitors with an opportunity to quickly implement a market response before the filed rates can even take effect. But it is customers who are ultimately harmed because this regulatory process virtually eliminates Ameritech as a source of competitive price pressure.[17]

In that regard, Ameritech also is the only carrier that is required to charge uniform rates throughout the entire State of Illinois (i.e., the Illinois study area), which means that customers are denied the benefits of an Ameritech competitive response to the initiatives of other carriers.[18] The end result is that competitive providers can undercut Ameritech's average price umbrella and cherry-pick the lowest cost, highest volume customers while still charging supra-competitive rates.[19] This disparate regulation of Ameritech denies customers the benefits of full

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[15] *Id.*

[16] See, generally, 47 C.F.R. §§ 61.38, 61.41-61.49.

[17] Aron Report at 11.

[18] 47 C.F.R. § 69.3(e)(7) (access tariffs filed by price cap LECs "shall not contain charges for any access elements that are desegregated or deaveraged within a study area that is used for purposes of jurisdictional separations"). Although Ameritech has established density pricing zones for access elements, pricing for each density pricing zone must be uniform within a study area. 47 C.F.R. § 69.123.

[19] See Aron Report at 3.

competition by unnecessarily restricting Ameritech's ability to compete vigorously in the provision of high capacity services in the Chicago LATA.

Ameritech's request for relief from dominant carrier regulation in the provision of high capacity services in the Chicago LATA satisfies the statutory criteria for forbearance. First, dominant carrier regulation of Ameritech's high capacity services is not necessary to ensure that rates and practices are just, reasonable, and not unreasonably discriminatory. Since Ameritech lacks market power, it does not have the power to control price in this market or the ability to act in a discriminatory manner. Customers would simply seek out the services of a competitor. Second, because Ameritech cannot control prices or act in an unreasonably discriminatory manner, the imposition of dominant carrier regulation on Ameritech high capacity services simply is not needed to protect consumers in the Chicago LATA. No consumers purchase these services, but carriers and businesses that do, could get service from another source if Ameritech "misbehaves." Third, continuing to subject Ameritech's high capacity services in the Chicago area to dominant carrier regulation deprives customers of the benefits of true competition by hampering Ameritech's ability to quickly and effectively respond to competitive initiatives. In sum, continued dominant carrier regulation of Ameritech's high capacity services in the Chicago LATA harms the public interest and contravenes the pro-competitive goals underlying the 1996 Act.[20]

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[20] Joint Explanatory Statement of the Committee of Conference, S. Conf. Rep. No. 230, 104 Congress, 2d Session 113 (1996).

Finally, Ameritech emphasizes that it is <u>not</u> requesting that its high capacity services be fully deregulated – it is requesting only that the Commission exercise its Section 10 forbearance authority and regulate Ameritech as a non-dominant carrier in its provision of high capacity services in the Chicago LATA. As a non-dominant provider, Ameritech should be subject to permissive detariffing, which would allow, but not require, the filing of tariffs on one-day's notice with a presumption of lawfulness and without any cost support.[21] The Commission also should free Ameritech's high capacity services from rate (price cap) regulation, which is appropriate only for dominant carrier services.[22] Moreover, the Commission should forbear from applying Section 69.3(e)(7) of its rules so that Ameritech can charge deaveraged rates within the Chicago LATA. The effect of granting this petition would be to benefit customers by permitting Ameritech compete equally with all other providers of high capacity services the Chicago area.

## II. AMERITECH SHOULD BE DECLARED NON-DOMINANT IN ITS PROVISION OF HIGH CAPACITY SERVICES IN THE CHICAGO LATA.

Ameritech's classification as a dominant carrier in the provision of telecommunications services is rooted in history. In 1980, the Commission found that AT&T, including its 23 associated telephone companies, and independent local telephone companies, as well, dominated the telephone market and needed to be

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[21] *In the Matter of Hyperion Telecommunications, Inc. Petition Requesting Forbearance,* CCB/CPD No. 96-3, Memorandum Opinion and Order and Notice of Proposed Rulemaking, FCC 97-219, 12 FCC Rcd. 8596 (released June 19, 1997) ("CAP Forbearance Order") (forbearing from requiring non-incumbent local exchange carrier providers of exchange access services to file tariffs).

[22] 47 C.F.R. §§ 61.41-61.49, 65.1(b).

regulated differently from emerging specialized common carriers ("SCCs") and resale carriers.[23] Since that time, with the advancement of technology, the high capacity services market has evolved into a highly-competitive one containing many competitors.

As demonstrated below, these developments -- and particularly how they have evolved in Chicago -- have rendered Ameritech incapable of exercising market power in the provision of high capacity services in the Chicago LATA. If Ameritech were to attempt to raise prices, either directly or through restricting output, its customers would quickly abandon Ameritech for one of the various competitive providers in the market

Moreover, in Chicago, Ameritech has had the ability to individually price high capacity intrastate exchange private line and special and dedicated switched access services in response to specific competitive situations since 1986.[24] Pursuant to that same authority, last year Ameritech began treating all intrastate private line and special access services as "competitive" -- subject to streamlined tariff filing on an individual customer basis. Yet Ameritech remains subject to the full range of dominant carrier regulation for the interstate versions of the identical services, while all other providers of these services are subject to streamlined regulation which permits them to compete in a manner more reflective of economic efficiency.

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[23] *In the Matter of Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, First Report and Order, FCC 80-629, 85 F.C.C.2d 1 (released November 28, 1980) at ¶¶ 60-65,79-83.

[24] See 220 Ill. Comp. Stat. 5/13-502.

The Commission should, therefore, exercise its Section 10 forbearance authority and regulate Ameritech in a manner that recognizes its non-dominant position as a provider of high capacity services.

### A. Defining the Relevant Market

In this petition, Ameritech has limited the scope of the relief it requests to the products and geographic area which are shown to be competitive in Dr. Aron's market analysis.

The Commission has defined a relevant product market as a service or group of services for which there are no close demand substitutes.[25] Both dedicated special access and switched transport services[26] provisioned at capacities of DS1 and higher may be used to transmit voice, data, or both, and may utilize either wireline or wireless technology. While these high capacity services may be provisioned at varying bandwidths using different technologies, they share the characteristic of offering carrier, business, and government customers substantial bandwidth on a dedicated basis. Thus, Dr. Aron notes that high capacity special access and switched transport services are "almost perfect supply-side substitutes."[27]

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[25] *In the Matter of COMSAT Corporation*, File No. 60-SAT-ISP-97 Order and Notice of Proposed Rulemaking, 13 FCC Rcd. 14083, (1998) ("Comsat Reclassification Order") at ¶ 25 (citing LEC Classification Order ¶¶ 41, 54) *(In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, 12 FCC Rcd. 15756 (1997) ("LEC Classification Order"))).

[26] And interstate intraLATA private line (point-to-point) services

[27] Aron Report at 6.

Nonetheless, Dr. Aron has treated them as separate products for analytical purposes:

> I will adopt the much simpler and more conservative approach of assuming the most narrow reasonable markets, and showing that the markets are competitive even under this most unfavorable assumption. This means that I will assume that, from a market definition standpoint, special access and dedicated transport are separate products in the Merger Guidelines' sense, and show that each is competitive.[28]

Further, in this petition, Ameritech seeks regulatory relief only for the Chicago LATA, limiting the geographic scope of its request to an area for which there is irrefutable evidence of competition.[29] Dr. Aron's report shows that Ameritech faces intense competition from established facilities-based providers in the provisioning of high capacity services in the Chicago area. In fact, competitive providers have substantial market share and more importantly are capturing an even higher share of the growth in demand for high capacity services. Based on this evidence, Dr. Aron concludes that the Chicago area market for high capacity services is highly competitive and that Ameritech lacks market power.[30]

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[28] *Id.*

[29] This in no way implies that there is an absence of competition in other areas served by Ameritech. In fact, Ameritech is marshalling evidence that it will use to support a petition that will request forbearance from dominant carrier regulation of its provision of high capacity services in other of its major metropolitan areas.

[30] Aron Report at 1-2, 29.

B. The Market for High Capacity Services in the Chicago Area Is Highly Competitive.

In assessing market power, the Commission is guided by well-accepted principles of antitrust analysis to determine whether a carrier is dominant in the relevant product and geographic market.[31] The Commission has relied on several factors as part of this analysis, including: (i) nature of market participants; (ii) market share; (iii) the demand elasticity of customers; (iv) the supply elasticity of the market; and (v) the carrier's cost, structure, size and resources.[32] Assessment of these general characteristics of the Chicago area market for high capacity services demonstrates that Ameritech cannot exercise market power.

1. Market Participants — There Are Well-Financed, Experienced Competitors in the Market.

The Chicago market for high capacity services is characterized by a number of established competitors with substantial resources. The following is a brief description of the facilities-based market participants included in the Aron Report:

AT&T/TCG has approximately 1000 route miles in the Chicago passing through the city's central business district and the vast majority of its densely-populated, business-intensive suburbs.[33] With the recent merger of TCG and AT&T, AT&T already has begun the process of migrating its dedicated high

[31] Comsat Reclassification Order at ¶ 67.

[32] *Id.*; see also *In the Matter of Motion of AT&T Corp. to Be Classified as a Non-Dominant Carrier*, Order, FCC 95-427, 11 FCC Rcd. 3271, (released October 23, 1995) ("AT&T Reclassification Order") at ¶38;

[33] Aron Report at 14-15.

capacity traffic from Ameritech to TCG. [34]

MCI/MFS WorldCom has 225 route miles of fiber in the Chicago area and approximately 400 buildings on its network.[35]

Although launching services in Chicago only early last year, NextLink already has 110 route miles of fiber in the Chicago LATA.[36]

In addition, WinStar and Teligent are using wireless technology to provide high capacity services in Chicago. In 1997, WinStar installed a lucent 5ESS switch and by October, 1998, had transmission facilities on 125 Chicago area rooftops. Its serving area includes some of Chicago's most communications-rich northern and western suburbs.[37]

Certainly, at least the two largest competitive providers are hardly "start-ups." Rather, these companies have access to substantial financial resources that can be used to fund expansion of their networks serving Chicago customers of high capacity services. For example, in the past two years, WorldCom acquired two competitive providers, MFS and Brooks Fiber, for a combined price of $16.4 billion. MCI/MFS WorldCom has 22 million customers and annual revenues of $30 billion.[38] Similarly, AT&T recently acquired TCG at a cost of $11.3 billion and is to acquire TCI at a cost of $48 billion and has entered into an agreement with Time Warner

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[34] http://www.czn.net/pressreleases/p082598a.html.

[35] Aron Report at 14.

[36] *Id.* at 15-16.

[37] *Id.* at 17.

[38] http://investor.mci.com/merger_overview/merger2.htm.

that could amount to more than $4 billion annually for exclusive use of its facilities to provide telephony.[39] The sheer size of the combined AT&T/TCG and MCI/MFS WorldCom companies dwarfs Ameritech.[40]

Equally as important, the recently completed mergers of TCG with AT&T and MCI with MFS WorldCom have resulted in the largest purchasers of high capacity services in Chicago having acquired the most extensive CAP fiber networks in Chicago. This is a significant development, given that AT&T/TCG and MCI/MFS WorldCom themselves account for approximately 61% percent of Ameritech's existing demand for high capacity service in the Chicago LATA. In fact, Ameritech already is experiencing the effects of these mergers, as significant portions of these customers' high capacity services are being migrated to the affiliated competitive fiber networks. For example, now that AT&T has completed its merger with TCG, AT&T has pledged to further reduce its dependence on Ameritech and other Bell companies and to commit "substantial resources" to continue building TCG facilities.[41]

Now that AT&T and MCI have access to their own high capacity facilities, the consolidations of AT&T and MCI with facilities-based access providers will result in the merged companies now competing head-to-head with Ameritech in the Chicago area market for high capacity services. Therefore, AT&T and MCI have an incentive to oppose Ameritech's request purely for their own business purposes.

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[39] The combined TCI/Time Warner arrangements will give AT&T direct access to 90% of the households in the top 100 U.S. markets. See note 9, *supra*.

[40] See Aron Report at 13.

The fact that Ameritech's two largest purchasers of access services now capable of supplying much of their own access needs, by itself, essentially evaporates whatever market power Ameritech may have otherwise had in Chicago.

### 2. Market Share — Competitors Have Captured a Significant and Growing Share of the Market.

Ameritech's declining market share for high capacity services in the Chicago area supports the conclusion that Ameritech lacks market power.[42] As Dr. Aron notes, competitive providers have captured 94% percent of the retail market for high capacity services.[43] This is a most important market share statistic because it identifies the carrier that has the direct account relationship with the ultimate user of the telecommunications service. In fact, the end user customer may not even be aware of the identity of the carrier actually provisioning the underlying high capacity facilities. Other retail services providers have a significant marketing advantage, even when Ameritech is the underlying facilities provider, since all carriers in the Chicago area, other than Ameritech, can take advantage of their relationships with the customer to offer a variety of services[44] including interLATA voice and data services.

Thus, the fact that Ameritech may be the underlying facilities-based provider

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[41] Communications Daily, July 27, 1998.

[42] See AT&T Reclassification Order at ¶ 67. However, declining market share is not itself a requirement for a finding of lack of market power. See Aron Report at 23-24.

[43] Aron Report at 19.

[44] *Id.*

in some of these competitive resale situations should not be interpreted as a lack of competitive pressure. The Commission has acknowledged the fact that competitive entry of resellers, some of which may grow to become regional or even national facilities-based competitors, puts downward pressure on prices. In its recent decision denying Personal Communications Industry Association's petition for forbearance from enforcing the resale rule as applied to PCS providers, the Commission stated that resellers exert downward pressure on rates through their ability to purchase services at high volume rates and pass through those savings to their customers.[45] The Commission also noted that resellers are able to offer their customers packages of services, some or all of which may be obtained from other providers, thereby enabling resellers to tailor service packages to meet each customer's particular mix of needs.[46] As discussed above, resellers of high capacity services (as retail providers) enjoy a significant competitive advantage over Ameritech because of their ability to offer a full service package that includes interLATA services.

Further, competitors' share of high capacity special access facilities (LDCs) had increased to almost 49% as of a year ago.[47] Moreover, competitive providers have acquired an ever increasing share of the market growth in the demand for

[45] AT&T Reclassification Order at ¶ 61. *In the Matter of Personal Communications Industry Association's Broadband Personal Communications Services Alliance's Petition for Forbearance For Broadband Personal Communications Services*, WT Docket No. 98-100, Memorandum Opinion and Order and Notice of Proposed Rulemaking, FCC 98-134 (released July 2, 1998) ("PCIA Forbearance Order") 13 FCC Rcd. 16857 at ¶ 35.

[46] *Id.*

[47] Aron Report at 20-21.

high capacity special access services in the Chicago area. During the period from fourth quarter 1996 to first quarter 1998, the competitive providers' market share of special access growth increased from less than 27% to almost 64%.[48] As Dr. Aron points out, share of growth, rather that static market share figures themselves, can be more reflective of the state of competition in markets undergoing transitions form monopoly status[49]. Share of growth is a primary indicator of what a competitor's installed-base market share will look like in the future – and competitive providers in the Chicago area have captured a majority share of market growth of high capacity special services over the past several years.

For dedicated transport, competitive providers, as of a year ago, had already captured 48% of the business in the city of Chicago and 28% in the suburbs.[50] These share figures, however, must be supplemented with an analysis of the pattern of collocation in the Chicago LATA. As Dr. Aron notes, collation is an indication that competitors have facilities in place to address dedicated switched transport demand.[51] Collocation arrangements are operational in offices representing 87% of switched access minutes in the city of Chicago and 63% of switched access minutes

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[48] *Id.* at 23-25.

[49] *Id.*

[50] *Id.*

[51] *Id.* at 22, 26-27.

in the suburbs.[52] In other words, the vast majority of Ameritech's dedicated switched transport business in Chicago is immediately addressable.

Thus, Ameritech's reduction in market share is largely the result of facilities build-out on the part of competitive providers in the Chicago area and their focus on the large business market. Moreover, Ameritech's share of this market segment is likely to decrease rapidly as customers, particularly the largest carrier customers, migrate traffic onto their own fiber networks. As discussed above, Ameritech is already feeling the impact of this migration.

### 3. Demand Elasticity — Customers Are Not Hesitant to Switch Providers.

Demand elasticity in this context refers to the willingness and ability of a carrier's customers to switch to a competitive provider, or to otherwise change the amount of services they purchase from the carrier in response to a change in the price or quality of the services.[53] High demand elasticity indicates that customers are willing and able to switch to another service provider in order to obtain price reductions or desired features. It also indicates that the particular service market is subject to competition.[54]

In granting non-dominant status to AT&T, the Commission observed that the demands of business customers are highly elastic because they are sophisticated buyers who typically receive and consider alternative proposals from several vendors and who act on the advice of consultants or in-house telecommunications

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[52] *Id.*

[53] Comsat Reclassification Order at ¶ 71.

experts.[55] They also are likely to engage in long-term planning and ordering.[56]

The Commission's observations, with respect to AT&T's and Comsat's customers' demand elasticity, apply with at least as much force to the class of customers who purchase high capacity services from Ameritech in Chicago – large carriers, medium to large business customers, and governmental entities. Clearly, this class of customers, with high volume telecommunication requirements, have no particular "brand loyalty" but rather have considerable negotiating power because of their sophisticated knowledge of telecommunications and their frequent use of outside network consultants or in-house expertise. Because of the volumes of traffic involved, these customers have both the incentive and the ability to drive a hard bargain for good prices and levels of service by the threat of going elsewhere. Moreover, the ability of Ameritech's largest carrier customers to migrate high capacity traffic to their own affiliated fiber networks further increases their bargaining ability.[57] As noted above, AT&T/TCG and MCI/MFS WorldCom by themselves account for more than 60% of the current demand for Ameritech's high capacity services in the Chicago LATA.

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[54] *Id.*

[55] AT&T Reclassification Order at ¶ 65.

[56] See Comsat Reclassification Order at ¶72.

[57] See Aron Report at 7-8. The fact that Ameritech normally provides high capacity services under term agreements (as do other providers) does not iteself present a barrier to competition in a fast growing market such as Chicago. The growth or new demand, of course, is not subject to termination charges. Moreover, Ameritech's termination charges have never failed to pass muster with the Commission since they only require that the customer pay for service at the rate applicable to the longest term that the customer actually took the service.

These demand elasticity characteristics are further reinforced by the overwhelming market share Ameritech's competitors have in the retail segment of the Chicago area market for high capacity services. The competitors already have established the relationship with the end user customer; and, even in those cases in which Ameritech is the underlying facilities provider, these competitors are in a position to shift to another provider or self-provision in a way that is transparent to the end user.[58]

4. Supply Elasticity — Sufficient Competitive Facilities Are Available.

Supply elasticity refers to the ability of suppliers in a given market to increase the quantity of services (capacity) supplied in response to an increase in price. There are two factors that determine supply elasticities in the market. The first is the supply capacity of existing competitors, because supply elasticities tend to be high if existing competitors have or can easily acquire additional capacity in a relatively short time period. The second factor is the existence of low barriers to entry, because supply elasticities tend to be high if new suppliers can enter the market relatively easily.[59]

Dr. Aron concludes that the market share figures alone demonstrate that Ameritech has no dominance in the Chicago area market for high capacity services.[60] Nonetheless, Dr. Aron proceeds to look at the ready availability of

[58] Aron Report at 19-20.

[59] Comsat Reclassification Order at ¶ 78.

[60] Aron Report at 25.

competitive capacity since the market share information is "likely to underestimate the importance of Ameritech's competitors in the market."[61]

As Dr. Aron notes, the three fiber-based competitors included her analysis have installed more than 1300 route miles of optical fiber in the Chicago MSA.[62] With current technology, these competitive fiber networks should be capable of transporting more traffic than the Chicago area will ever generate. Indeed, equipped as they are today, the competitive fiber backbone networks have more than sufficient capacity to accommodate the current demand for Ameritech's high capacity service. Relative to special access, Dr. Aron notes that fiber maps (which do not reflect all competitive facilities available today) show that at a minimum, competitor's facilities are already located in wire centers representing more than 87% of Ameritech's high capacity revenues and more than 94% of its special access LDCs.[63] With respect to dedicated switch transport, Dr. Aron shows that operational collocation arrangements — which indicate the presence of in-place facilities capable of handling dedicated switched transport — are present in offices representing almost 70% of the switch access minutes in the LATA, 88% of the minutes in the city of Chicago, and 63% of the minutes in the suburbs.[64]

Finally, the impressive growth of competitive provider's market share in the Chicago area market for high capacity services itself demonstrates that supply is

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[61] *Id.* at 26.

[62] *Id.* at 14-16.

[63] *Id.* at 27-28.

[64] *Id.* at 25.

highly elastic, the cost of entry is not prohibitive, and that there are no legal barriers to entry.[65]

5. Ameritech's Cost, Structure, Size and Resources Give It No Unfair Advantage.

In the AT&T Reclassification Order, the Commission addressed the question of whether AT&T's size relative to other carriers might give it an unfair competitive advantage in terms of scale economies and access to capital. The Commission clarified:

> As we noted in the First Interchange Competition Order, the "competitive process itself is largely about trying to develop one's own advantages, and all firms need not be equal in all respects for this process to work." (Citation omitted.)[66]

Ameritech does not enjoy any unfair advantage in this respect in the Chicago area market for high capacity services. While, in its evaluation of AT&T's advantages, the Commission considered the fact that AT&T faced at least two "full-fledged facilities-based competitors" in the long distance market,[67] Ameritech faces similar well-established facilities-based competitors in the Chicago area and numerous additional new entrants. As discussed above, the combined AT&T/TCG and MCI/MFS WorldCom entities have a significant advantage in terms of scale economies and access to capital, as well as the advantage of being able to provide

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[65] *Id.* at 25.

[66] AT&T Reclassification Order at ¶ 73. The Commission recently held that Comsat does not have market power, notwithstanding its finding that Comsat has competitive advantages in size and access to resources. Comsat Reclassification Order at ¶ 93.

[67] AT&T Reclassification Order at ¶ 70.

interLATA services.

C. Ameritech Lacks Market Power in the Chicago Market for High Capacity Services.

Under its Competitive Carrier paradigm, the Commission has consistently held that a carrier is dominant only if it possesses market power in the relevant product and geographic market.[68] Conversely, a carrier qualifies as non-dominant if it lacks market power in the relevant market.[69] In making a determination about whether a carrier has market power, the Commission analyzes whether the carrier has the ability to "raise prices above competitive levels and maintain that price for a significant period, reduce the quality of the relevant product or service, reduce innovation or restrict output profitably."[70]

As Dr. Aron shows, the evidence presented in support of this petition compels the conclusion that Ameritech lacks market power in the Chicago area market in its provision of high capacity services.[71] Dr. Aron demonstrates that the market for high capacity services in Chicago fully exhibits the indicia of competition used by the Commission previously in its analysis of market dominance. In particular: (1) Competitors have a significant market share, serving 94% of the retail market, providing 49% of the special access LDC facilities and capturing 64% of new demand; they also have a substantial share of the dedicated transport market as

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[68] See, e.g., *id.* at ¶ 138.

[69] *Id.*

[70] Comsat Reclassification Order, ¶ 67; see also *In the Matter of the Merger of MCI Communications Corporation and British Telecommunications plc,* Memorandum Opinion and Order, 12 FCC Rcd. 15351, at ¶ 124 (1997); Bell Atlantic/NYNEX Order, 12 FCC Rcd. at 20038 ¶ 101.

[71] Aron Report at 2, 4, 29.

well; (2) customers for these services (e.g., large businesses and other carriers) are highly sensitive to price and other service characteristics; (3) alternative providers have plenty of capacity (and the ability to expand their facilities) to capture Ameritech's existing business, and there are minimal barriers to entry; and (4) Ameritech's size does not provide it with an insurmountable or unfair advantage. In light of Ameritech's lack of market power, Dr. Aron concludes that competition itself, without dominant carrier regulation, is sufficient to ensure just and reasonable rates and practices, to protect consumers and is consistent with the public interest.[72]

## III. FORBEARANCE FROM DOMINANT CARRIER REGULATION OF AMERITECH' S PROVISION OF HIGH CAPACITY SERVICES IN THE CHICAGO LATA IS JUSTIFIED.

Section 10 of the 1996 Act requires that the Commission "forbear from applying any regulation or any provision of this [Act] to a telecommunications carrier or telecommunications service, or class of telecommunications carriers or telecommunications services, in any or some of its or their geographic markets" if the Commission finds that:

> (1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;
>
> (2) enforcement of such regulation or provision is not necessary for the protection of consumers; and
>
> (3) forbearance from applying such provision or regulation is consistent with

[72] *Id.* at 9-11, 29..

the public interest.[73]

In making the public interest determination, Section 10 requires that the Commission consider whether forbearance will promote competitive market conditions, including the extent to which forbearance will enhance competition among providers of telecommunications services.[74]

Based on the compelling economic evidence of the preceding section, Ameritech respectfully suggests that the Commission must forbear from regulating it as a dominant carrier in its provision of high capacity services in the Chicago area. In particular, the Commission should forbear from applying the following regulations: (1) the requirement that incumbent LECs (but not providers other than incumbent LECs) must file tariffs for high capacity services;[75] (2) sections 61.38 and 61.41-61.49, which require dominant carriers to file tariffs on up to 15-days' notice with cost support;[76] (3) section 69.3(e)(7), which requires averaged rates within a study area;[77] (4) sections 61.41-61.49 and 65.1(b) which impose price cap (rate) regulation on dominant carriers;[78] and (5) <u>any</u> other of its rules that would currently apply to Ameritech as a dominant provider, but not to other non-dominant providers of high capacity services in the Chicago LATA.

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[73] 47 U.S.C. § 160(a).

[74] 47 U.S.C. § 160(b).

[75] See CAP Forbearance Order (forbearing from requiring non-incumbent LEC providers of exchange access services to file tariffs).

[76] 47 C.F.R. §§ 61.38, 61.41-61.49.

[77] 47 C.F.R. § 69.3(e)(7).

[78] 47 C.F.R. §§ 61.41-61.49, 65.1(b).

A. Dominant Carrier Regulation of Ameritech's Provision of High Capacity Services in Chicago Is Not Necessary to Ensure that Rates and Practices Are Just, Reasonable, and Not Unreasonably Discriminatory.

The first statutory criterion for forbearance requires that the Commission determine whether dominant carrier regulation of Ameritech's provision of high capacity services in the Chicago LATA is necessary to ensure that rates and practices are just, reasonable and not unreasonably discriminatory. As the Commission recognized, it is "highly unlikely" that carriers lacking market power could successfully charge rates or engage in practices that violate the Act, because an attempt to do so would prompt customers to switch to different carriers.[79] For that reason, the Commission has determined that tariffing is not necessary to ensure reasonable rates and practices for carriers that lack market power.[80] In this case, the evidence shows that the market for high capacity services in the Chicago LATA is sufficiently competitive that there is no reason to regulate any carrier as dominant.

Since Ameritech does not possess market power in its provision of high capacity services in the Chicago LATA, it is simply unnecessary to require Ameritech to file dominant carrier tariffs or to comply with other aspects of dominant carrier regulation, such as the rate averaging requirement.[81] Rather,

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[79] PCIA Forbearance Order, 13 FCC Rcd. at 16885 ¶ 57 (citing CAP Forbearance Order, at ¶ 23; *In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Second Report and Order, 11 FCC Rcd. 20730, 20742-47 ¶¶ 21-28 (1996) ("IXC Forbearance Order")).

[80] CAP Forbearance Order at ¶ 23; IXC Forbearance Order at ¶ 21.

[81] As noted above, the fact that Ameritech may de-average rates by specific zones still preludes appropriate response to the presence of the pervasive competition in the area.

forbearance would mean treatment of Ameritech consistent with every other non-dominant carrier in the Chicago high capacity market. This would include permissive detariffing, which would allow, but not require, the filing of tariffs on one-day's notice with a presumption of lawfulness and without any cost support.[82] Marketplace forces will effectively preclude Ameritech from charging unreasonable rates or otherwise behaving unreasonably in its provision for high capacity services in the Chicago LATA.

Moreover, as the Commission has already found in other contexts, other regulations are sufficient to ensure that non-dominant carriers do not attempt to charge unreasonable rates or otherwise engage in unreasonable practices. In particular, Sections 201 and 202 of the Act require that rates and practices be just, reasonable, and not unreasonably discriminatory.[83] In those circumstances in which the Commission has classified carriers as non-dominant because they lack market power, it has continued to require compliance with Sections 201 and 202.[84] The Commission has observed that it can address any issue of unlawful rates or practices through the exercise of its authority to investigate and adjudicate complaints under Section 208.[85]

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[82] CAP Forbearance Order, at ¶ 27. It should be noted that the Commission tentatively concluded that it should adopt mandatory detariffing for interstate exchange access services, as it previously adopted for interexchange services. *Id* at ¶ 34.

[83] 47 U.S.C. §§ 201(b), 202(a).

[84] PICA Forbearance Order at ¶ 17.

[85] *Id.*

B. Dominant Carrier Regulation of Ameritech's Provision of High Capacity Services in Chicago Is Not Necessary to Protect Consumers.

The second statutory criterion for forbearance requires that the Commission determine whether dominant carrier regulation of Ameritech's provision of high capacity services in Chicago is necessary for the protection of consumers. No "consumers" -- as that term is commonly used and understood -- purchase the services in question. However, as demonstrated in the previous section, dominant carrier regulation is not necessary to assure that Ameritech's rates and practices are just, reasonable and not unreasonably discriminatory with respect to those large, telecommunications-savvy businesses and carriers that do purchase these services. Because Ameritech lacks market power, rates for high capacity services will be effectively constrained by market forces. Further, the requirements of Sections 201 and 202 serve as additional safeguards for customers. Therefore, if dominant carrier regulation of Ameritech is not necessary to protect the large companies that purchase high capacity services, it is not necessary to protect consumers who do not. Accordingly, the second criterion is satisfied.[86]

C. Forbearance From Applying Dominant Carrier Regulation to Ameritech's Provision of High Capacity Services in Chicago Is Consistent with the Public Interest.

The third statutory criterion for forbearance requires that the Commission determine whether forbearance from applying dominant carrier regulation to Ameritech's provision of high capacity services in Chicago is consistent with the

[86] PCIA Forbearance Order at ¶ 58; CAP Forbearance Order ¶ 26.

public interest. In making this public interest determination, the Commission considers whether forbearance will "promote competitive market conditions, including the extent to which forbearance will enhance competition among providers of telecommunications services."[87] Continuing to regulate Ameritech as a dominant carrier in its provision of high capacity services results in competitive distortions that do not serve the public interest and retard -- not enhance -- competition.[88]

In the AT&T Reclassification Order, the Commission described in detail the significant social costs of continued asymmetrical regulation: (1) the longer tariff notices imposed on AT&T dampened its incentives to innovate because rivals could respond to innovations before they were allowed to go into effect; (2) the tariff filing requirements also dampened AT&T's incentives to reduce prices; (3) AT&T's competitors could use the asymmetrical regulatory process to delay and undermine its initiatives; and (4) regulation imposed administrative costs on both AT&T and the Commission.[89]

Dr. Aron concludes that dominant carrier regulation of Ameritech in the Chicago market for high capacity services market involves the same kinds of social

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[87] Comsat Reclassification Order at ¶ 151; see also PCIA Forbearance Order at ¶ 27.

[88] See Aron Report at 9-11.

[89] AT&T Reclassification Order at ¶ 32; see also PCIA Forbearance Order ¶ 30 (Forbearance from enforcing Sections 201 and 202 with regard to broadband PCS carriers alone would create regulatory asymmetry with respect to cellular and other CMRS providers that would "distort competition and contradict the intent of Congress that CMRS providers should be treated similarly.")

costs.[90] The 15-day tariff notice requirement, which applies only to Ameritech, gives competitive providers the opportunity to respond to Ameritech's filed rate or be the first to market with a new service offering even before Ameritech's tariff becomes effective. Further, as a dominant carrier, Ameritech also is prohibited from responding to competition by charging deaveraged rates within the zone and study area.

Moreover, continuing to regulate Ameritech as a dominant carrier in a competitive market results in providing competitors with a price "umbrella". Competitors will argue that Ameritech's proposed tariff rates are unlawfully low while pricing their own services below those very rates -- but just low enough to capture the business.[91] The Commission has recognized that requiring tariff filings may facilitate tacit collusion by enabling carriers to "ascertain competitors' prices and any changes to rates, which might encourage carriers to maintain rates at an artificially high level."[92] In comparison, forbearance of the tariff filing requirements "will foster competition which will expand the consumer benefits of a competitive marketplace."[93] Thus, dominant carrier regulation reduces the incentive of all competitors to initiate price reductions and introduce new services, and adversely affects Ameritech's ability to respond quickly and creatively to competition.

Dominant carrier regulation also imposes significant compliance costs on

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[90] Aron Report at 9-11.

[91] *Id.*

[92] *Implementation of Sections 3(n) and 332 of the Communications Act, Regulatory Treatment of Mobile Services*, GN Docket No. 93-252, Second Report and Order, 9 FCC Rcd. 1411 at ¶177 (1994).

[93] *Id.*

Ameritech and administrative costs on the Commission which are unnecessary in a competitive environment. The submission of detailed cost support with each tariff filing increases the cost of implementing new services and rate structures. These regulatory costs are passed through to high capacity customers in the form of higher rates.[94] Because Ameritech is the only provider of high capacity services in the Chicago LATA that is forced to incur the regulatory costs associated with dominant carrier regulation, it suffers a unique competitive disadvantage. In comparison, permissive detariffing of these services "would reduce administrative burdens on carriers [Ameritech] and on the Commission, promote competitive market conditions, facilitate provision of new service offerings, and promote market entry."[95]

Moreover, there are broader public interest issues at stake in this proceeding. In order to ensure the continued development and modernization of the public switched telephone network and the availability of sophisticated and innovative services – both of which are the central goals of the 1996 Act – all competitors, including incumbents, must be free from restrictions and handicaps on their ability to compete in the marketplace. In other words, all competitors should be faced with the same market incentives to undertake the risky investments needed for innovation. The market, of course, does a better job than regulation -- and a much better job than asymmetrical regulation -- in exerting pressure to be efficient and

[94] Certainly, these costs can be factored into the rates for new services. Even with respect to rates subject to price caps, these types of costs could well affect a decision about whether to lower rates below the cap.

[95] PCIA Forbearance Order at ¶ 64 (citing CAP Forbearance Order at ¶¶ 27-32).

innovative.

Further, the market encourages innovation by allowing participants to retain the profits from innovations that are successful, just as they are forced to bear the full cost of failed attempts. Such symmetry is absent from dominant carrier (rate) regulation and can be achieved only through true deregulatory changes

The Commission's own experience with AT&T and the long distance industry demonstrates the public interest benefits of a free market system. At the time, the Commission's decision to reclassify AT&T as non-dominant was strongly opposed by AT&T's competitors. However, the Commission recognized that allowing AT&T to compete on equal terms with its competitors would spur increased competition in the long distance market. AT&T has continued to lose market share since it was declared non-dominant in 1995 while its competitors have thrived. That fact alone, although not necessary for the conclusion, is sufficient to find that the reclassification has not harmed what competition there was in the industry. Likewise, symmetrical regulation of Ameritech and competitive providers as non-dominant carriers would serve the public interest by promoting competitive market conditions and facilitating the introduction of new service offerings, service enhancements, and price reductions.[96]

[96] See Aron Report at 9-11.

## IV. REGULATING AMERITECH AS A NON-DOMINANT CARRIER IN ITS PROVISION OF HIGH CAPACITY SERVICES IN CHICAGO IS NOT TOTAL DEREGULATION.

Ameritech is not requesting that it be totally deregulated in its provision of high capacity services in the Chicago LATA – it is requesting only that the Commission exercise its Section 10 forbearance authority and regulate Ameritech as any other non-dominant provider of those services. As discussed above, like other non-dominant carriers, Ameritech would still be subject to regulation under Title II of the Communications Act of 1934, as amended. Like other, non-dominant carriers, it would still be required to offer those interstate services under rates, terms and conditions that are just, reasonable and not unreasonably discriminatory.[97] In addition, like other non-dominant carriers it would still be subject to the Commission's complaint process.[98]

As a non-dominant carrier, however, Ameritech would be subject to streamlined regulation equal to that of all other providers of high capacity services in the Chicago LATA. Ameritech would be subject to permissive detariffing, which would allow, but not require, the filing of tariffs for interstate high capacity services on one-day's notice with a presumption of lawfulness and without any cost support. Second, Ameritech's high capacity services in the Chicago LATA would be removed from price cap (rate) regulation. And Ameritech would be allowed to charge

[97] 47 U.S.C. §§ 201(b), 202(a).

[98] 47 U.S.C. §§ 208(a).

deaveraged rates for its high capacity services within the Chicago LATA. The effect of granting this petition would be to permit customers these benefits of Ameritech's being able to compete on an equal footing with all other providers of high capacity services in the area.

## V. CONCLUSION

Congress adopted Section 10 because it recognized that regulation is unnecessary, and indeed harmful, in a competitive market. Under Section 10, the Commission is required to eliminate regulations that are no longer necessary to ensure that rates and practices are just, reasonable and not unreasonably discriminatory. The evidence offered by Ameritech in support of this petition demonstrates that the market for high capacity services in the Chicago area is vigorously competitive. In light of the fact that Ameritech lacks of market power, competition, without dominant carrier regulation, is sufficient to constrain any ability that Ameritech may have otherwise had to impose unreasonable prices or other terms and conditions of service.

Section 10 also requires that the Commission consider whether forbearance will promote competitive market conditions. There is no question that allowing Ameritech to compete on equal footing with other providers of high capacity services serves the public interest and enhances competition. Today, Ameritech is uniquely hampered by dominant carrier regulations that restrict its ability to freely compete in the Chicago area market for high capacity services. Removing these regulatory obstacles will allow Ameritech to initiate price reductions and new services, and to respond quickly and creatively to competition, thus benefiting customers.

For these reasons, the Commission should grant this petition and forbear from regulating Ameritech as a dominant carrier in its provision of high capacity services in the Chicago LATA.

Respectfully submitted,

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# AN ANALYSIS OF MARKET POWER IN THE PROVISION OF HIGH-CAPACITY ACCESS IN THE CHICAGO LATA IN SUPPORT OF AMERITECH'S PETITION FOR SECTION 10 FORBEARANCE

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**LECG, Inc.**

# AN ANALYSIS OF MARKET POWER IN THE PROVISION OF HIGH-CAPACITY ACCESS IN THE CHICAGO LATA IN SUPPORT OF AMERITECH'S PETITION FOR SECTION 10 FORBEARANCE

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## I. INTRODUCTION

Competition in the provision of high-capacity services is prevalent and growing in metropolitan areas throughout the country. Ameritech currently is marshalling evidence of competition that will demonstrate that it is in the public interest to remove dominant carrier status from Ameritech in all of its major metropolitan areas. This case will be presented in the near future. In Chicago, however, competition is such that Ameritech need not and should not wait to gather additional evidence and analysis. Competitive providers of these services – interexchange carriers (IXCs) and competitive local exchange carriers (CLECs) are well established in Chicago today by any measure of competition. Given the level and aggressive nature of competitors in Chicago, dominant carrier status restricts the benefits of competition that customers would otherwise enjoy and places Ameritech at an unreasonable competitive disadvantage.

Ameritech is petitioning the Federal Communications Commission ("FCC") under Section 10(a) of the Communications Act of 1934 (as amended by the Telecommunications Act of 1996) to forbear from regulating Ameritech as a dominant carrier of high-capacity access services (special access and dedicated transport for switched access) in the Chicago Local Access Transport Area (LATA). If granted non-dominant status in this market, the FCC will forbear from:

1. requiring tariffs with 15 days advance notice and cost support;
2. imposing price-cap (rate) regulation;
3. mandating geographic price averaging – even within predetermined zones; and
4. imposing any other requirements on Ameritech that it does not also impose on other non-dominant providers.

These restrictions were deemed necessary and beneficial when Ameritech was the dominant provider of high-capacity services. These same restrictions, however, are counterproductive in today's competitive market. They retard the continued development of efficient and beneficial competition in the high-capacity services market in Chicago by actively preventing Ameritech from being an effective competitor. The FCC must grant forbearance under Section 10(a) if it determines that there is sufficient competition in the market that dominant carrier regulation is:

1. unnecessary to ensure that Ameritech's rates and practices are just and reasonable;
2. unnecessary to protect consumers; and
3. its elimination is consistent with the public interest.

The evidence shows that there is sufficient competition among providers of high-capacity services in the Chicago LATA to ensure that the criteria for forbearance are satisfied.

Upon review of the nature of the competitors, measures of simple market shares, shares of market growth, fiber route maps, and collocation, it becomes clear that Ameritech is no longer the dominant provider of high-capacity access services in this market. In particular, our analysis shows that Ameritech does not have market power in the Chicago LATA by the standards of the federal Merger Guidelines.

The competitive situation in Chicago today is the result of years of aggressive competitive activity. The nation's leading competitive access providers, MFS and TCG, years ago recognized Chicago as an important market and are now well-established providers of high-quality, low-cost services. These high-capacity service competitors in Chicago are now backed by the financial might of MCI WorldCom and AT&T, making them more formidable than ever. WinStar and Teligent, two leading providers of wireless high-capacity services, are also active in the Chicago market.

In Chicago, Ameritech's competitors already have captured large shares of the market. Indeed, in the retail market, Ameritech is no longer a meaningful player at all. Ameritech now holds 6% of the retail market share in the Chicago special access market.[1] As for the underlying facilities, competitors controlled almost half of the special access market in the first quarter of 1998,[2] measured in DS1 equivalent lines.[3] This measure is likely to understate the competitors' market share in terms of revenue, and indeed the top two IXCs alone, MCI WorldCom and AT&T, are known to have fiber already in place in wire centers that account for 87.2% of Ameritech's total high-capacity revenue in the Chicago LATA, and which account for 94.2% of Ameritech's special access LDCs in service.[4] In the dedicated transport market, competitors likewise have established operational collocation in wire centers that account for 69.1% of the switched access minutes of use in the LATA.[5] Competitive local exchange carriers (CLECs) and interexchange carriers (IXCs) are increasing their market shares by capturing existing business from Ameritech and by winning the majority of the substantial growth in the market.

Ameritech surely is not the dominant provider of high-capacity services in the Chicago LATA today. Hamstrung by the requirements attendant to a dominant carrier, Ameritech cannot help bring customers the full benefits of competition because it is at a serious and

1 Data provided by Ameritech.

2 Quality Strategies, *Ameritech Chicago HICAP Track Report,* First Quarter 1998. (Exhibit 8.) Quality Strategies, a market research firm, was retained by Ameritech at various times in previous years to estimate market shares and provide overviews of the status of competition in the high-capacity market. Many of the figures in this report are derived from their studies.

3 These figures are measured on a DS1 equivalent basis. All Quality Strategies market share statistics quoted in this report are for the Chicago MSA rather than the LATA, because Quality Strategies did not collect market share information on a LATA basis. However, the MSA represents virtually all of the high-capacity business in the LATA. Specifically, 94.9% of Ameritech's high-capacity revenues in the LATA derive from wire centers located within the MSA. Hence, we feel these statistics accurately describe the competitiveness of the high-capacity access business of the LATA as a whole.

4 Data provided by Ameritech.

5 Data provided by Ameritech.

unfair competitive disadvantage relative to the aggressive, well established, and financially powerful firms providing-high-capacity services in Chicago today.

Due to the urgency of the situation in Chicago and the convincing evidence that Ameritech is not a dominant provider in this market, this abbreviated petition seeks forbearance for the Chicago LATA only. The fact that Ameritech is filing first in Chicago is not an indication that the competitive landscape in a market must be as developed as it is in Chicago for the FCC to legitimately forbear from regulation. It is not necessary for competition to have progressed to the level it has in Chicago for a carrier to be disciplined by the market and to lack any significant market power. Ameritech plans to request non-dominant treatment in additional markets once it completes its analysis for other major metropolitan areas. In those areas where competition is less fully developed than it is in Chicago, an examination of the viability of entry and expansion of competitors, which might involve a closer look at the fiber route structure, incumbent customer locations, and costs of expanding service. However, the evidence of robust competition for high-capacity service in Chicago is sufficiently strong on its face that the FCC should grant forbearance in Chicago without delay.

Maintaining the classification of Ameritech as a dominant provider, when it clearly is not, is harmful to the continued development of competition. First, the dominant classification is diminishing Ameritech's role as a meaningful competitor in the Chicago area. This unduly restricts competition. Second, restrictions on Ameritech's pricing flexibility are providing pricing umbrellas for alternative providers of high-capacity services that, in some instances, could be maintaining prices that are less cost-based than the forces of competition would normally permit. The market for these services in Chicago has changed in the past several years. These changes have transformed any benefits that may have derived from regulating Ameritech as a dominant carrier during the early stages of competition into hindrances to the continued development of efficient competition in this market today.

In the following section, I discuss the economic approach to assessing market power as articulated in the U.S. Merger Guidelines and endorsed by the FCC. In Section III, I explain why continued dominant carrier regulation is injurious to competition and why it would be in the public interest to allow Ameritech the same pricing flexibility that its competitors are permitted to exercise. In Section IV, I describe the market participants in greater detail and present the quantitative evidence that Ameritech is no longer the dominant provider of high-capacity services in the Chicago LATA. The quantitative evidence falls into four categories: market shares, shares of market growth, operational collocation, and near-ubiquity of competitors' fiber in the areas of high-capacity demand. I discuss each in turn. Section V contains my conclusions that competition in the Chicago LATA is sufficient to constrain Ameritech from any harmful exercise of market power, and that forbearance is in the public interest. The public is harmed by this asymmetric regulation, and competition would be enhanced by the removal of these constraints.

An understanding of the methods of provisioning the services is critical to understanding the economics of the market and the degree of competition. For the benefit of readers not fully familiar with the provisioning of access services, I describe the relevant technical features of the services in Appendix I. In Appendix II, I discuss in some detail the economics of proper definition of the product and geographic markets in the provision of high-capacity services. Appendix III describes my qualifications.

## II. THE ECONOMIC APPROACH TO ASSESSING MARKET POWER

The purpose of this report is to demonstrate that a proper economic evaluation of the high-capacity market in Chicago clearly leads to the following conclusions: Ameritech faces powerful competitive discipline in Chicago; Ameritech does not have market power by the commonly adopted antitrust standards, and continued regulatory oversight would hinder the efficient and vigorous functioning of competition in that market. Our analysis derives from Section 10's statutory forbearance criteria. The criteria for forbearance are based on a "sufficient competition" standard, where "sufficient" means that the competitive discipline in the market protects customers and the public interest from a harmful exercise of market power by the incumbent. To measure the "competitiveness" of a market, economists in the field of antitrust examine demand, supply, and entry conditions according to a protocol articulated in the Merger Guidelines issued by the U.S. Department of Justice and the Federal Trade Commission.[6] In previous proceedings the FCC has endorsed this methodology.[7] The premise of the approach is that: 1) an examination of the conditions of demand, supply, and entry provide an accurate assessment of market power for a provider; and 2) demonstrating that a provider lacks significant market power is sufficient to conclude that the provider cannot harm customers or competition, and that the competition in the market serves the public interest.

The Merger Guidelines articulate a highly specific protocol for determining market power created by a merger. Although the market power issues pertinent to this petition are unrelated to any merger, the economic principles of the merger guidelines can nevertheless be applied to a significant extent to this case. Hence, because the FCC has endorsed the Merger Guidelines' approach to examining market power, the framework

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6 See *Department of Justice and Federal Trade Commission Horizontal Merger Guidelines* (the "*Merger Guidelines*"), April 2, 1992.

7 See, for example, Federal Communications Commission, *In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier,* Order, FCC 95-427, October 12, 1995 (*"AT&T Reclassification Order"*); *In the Matter of Motion of AT&T Corp. to be Declared Non-Dominant for International Service,* Order, FCC 96-209, May 9, 1996 ("*AT&T* (International) *Reclassification Order"*); *In the Matter of COMSAT Corporation Petition ... for Forbearance from Dominant Carrier Regulation and for Reclassification as a Non-Dominant Carrier, et al.,* Order and Notice of Proposed Rulemaking, FCC 98-78, April 24, 1998 (*"COMSAT Reclassification Order").*

for our analysis will follow the Merger Guidelines to the extent appropriate for the instant context (a deregulating market, not a merger).

The Merger Guidelines' approach posits that market power can be constrained, generally speaking, by two forces: actual competition, and potential competition.[8] Actual competition can be assessed using measures of the presence of competitors, such as share of market revenue, share of market capacity, and share of growth of the market. To the extent that other measures of extant competition are relevant in particular markets, the Guidelines ascribe them validity at least as great as market share.[9] It will become clear that conventional measures of current competition (i.e., market shares), while quite strong evidence of competition in the Chicago LATA, do not fully measure the level of potential competitive activity. The providers who are currently serving the high-capacity market and have fiber traversing Ameritech's wire center serving areas have huge amounts of capacity and can easily and quickly expand their fiber networks (or use other means) to serve customers in contiguous areas without incurring significant sunk costs. According to the Merger Guidelines, providers who are not currently supplying service to a given set of customers nevertheless may be deemed to be relevant competitors for those customers and impose a competitive constraint if they are reasonably poised to begin providing service. These sources of competition impose a significant competitive discipline on the market.

In addition to these sources of competition, potential competition, or entry, is generally thought to provide competitive discipline on a market if, in response to an attempted price increase, entry would be "timely, likely, and sufficient in its magnitude" to defeat the price increase or render it unprofitable.[10] In markets where potential entry passes this test, the antitrust authorities consider a merger to be of no anticompetitive concern, regardless of the level of actual competition or market shares. Entrants may need to make significant sunk investments to enter, but if entry can occur in sufficient magnitude to counteract an attempted small but significant price increase within two years from the initial planning to significant market impact, entry is considered to be timely. In the access market, "sufficient magnitude" would not require that entrants be willing and able to build out to every potential customer within two years; but rather that entrants would be willing and able to build out or otherwise provide service to a reasonable share of customers so that implementing a price increase would not be a profitable strategy for Ameritech.[11] In Section IV, we will demonstrate that not only is actual competition, as measured by competitors' actual provision of service, vigorous in the Chicago LATA, but

8 *Merger Guidelines*, §§ 1.31, 1.32, 3.0.

9 For example, the Merger Guidelines will include "uncommitted entrants" in the market if their inclusion "would more accurately reflect probable supply responses." (*Merger Guidelines,* § 1.32).

10 *Merger Guidelines*, § 3.0.

11 If Ameritech were to increase prices to customers who were previously being served at below-cost prices, entrants would have little incentive to build-out to serve these customers. However, such price increases would not be of competitive concern because increasing prices that are below cost is socially beneficial, not harmful.

competitors are poised to expand further from their already extensive networks. The description in Section IV of the history of competitive entry in Chicago will make clear that two years is not an aggressive timetable for entrants to expand their networks, particularly given that their networks are nearly ubiquitous now in the most significant areas of high-capacity demand.

To determine which firms participate in the relevant market and which suppliers represent potential entrants into the relevant market, one first must define what the relevant market is. In this case, because Ameritech's petition seeks forbearance on both special access and on dedicated transport for switched access, the relevant product market definition question is whether these two services are part of the same product market, or whether they form distinct product markets. The task is complicated, however, by the fact that these services are not entirely separable technologically. In particular, dedicated transport for special access, a component of special access service, is technologically indistinguishable from dedicated transport for switched access. As I explain in detail in Appendix II, then, the more appropriate question is whether special access is in a separate product market from dedicated transport (independent of whether the transport is carrying switched or special access traffic).

The prescribed methodology for defining the product market is somewhat arcane, however, and in my judgment, the exercise is not necessary for purposes of this report. There are two reasons that a detailed market definition analysis is not necessary in the access market. The first reason is that, instead of developing the often-delicate evidence and arguments for defining a specific alleged market, I will adopt the much simpler and more conservative approach of assuming the most narrow reasonable markets, and showing that the markets are competitive even under this most unfavorable assumption. This means that I will assume that, from a market definition standpoint, special access and dedicated transport are separate product markets in the Merger Guidelines' sense, and show that each is competitive.

The second reason that market definition analysis is not necessary is that the Merger Guidelines' style of market definition is performed from the demand side only (i.e., it considers only whether *customers* view the services as close substitutes); it does not consider whether the products are substitutes in *supply*. The supply-side analysis is relevant in determining which providers are in the market, but not which products are in the market. This subtle distinction is academic, however, in a market such as access, where special access and dedicated transport for switched access are, from a technical (supply) standpoint, identical products (with the exception of the Local Distribution Channel, as I explain in Appendix I). Hence, whether special access and dedicated transport are in separate or different product markets from a demand-side (Merger Guidelines) standpoint, the providers of capacity in the market(s) are clearly the same in any case. As I explain in the Appendix, if a provider offers special access, it can by definition (and does) offer dedicated transport, and vice versa. There is no question that the products are almost perfect supply-side substitutes.

In Appendix II, I discuss the formal approach to defining product markets in the access context. In addition, I discuss the more complex issue of a proper formal definition of geographic markets. For purposes of the analysis that follows, however, it is sufficient to note that we analyze competition in the Chicago LATA, which may consist of many geographic "markets" from an antitrust standpoint. In my judgment, a proper and tractable assessment of market power in a geographic region requires that competitive alternatives be reasonably dispersed throughout the areas in the region where there is demand for the service. To conclude that there is competition in a geographic region requires that a reasonable subset of the narrowly defined geographic markets throughout the region be competitive. Hence, if actual competition is sparse in some sizeable areas where there is significant demand for the service or there may reasonably be demand in the near future, it is appropriate to conduct a detailed geographic analysis of the costs and incentives of providers with existing networks to build out to those customers. If actual competition is relatively dense in the areas where there is demand for the product, however, a detailed cost analysis is unnecessary because it is clear that customers already have realistic competitive alternatives. As we will show, the Chicago market is in the latter category.

Of course, for competitive providers to pose significant competitive discipline on Ameritech, a sufficient number of customers must be willing to switch between suppliers if provided a price incentive to do so. This is clearly the case in the access market. Most high-capacity access customers are large corporations and IXCs. Corporations generally limit their participation to the retail special access market, while IXCs are the primary customers of transport and wholesale special access. Both groups tend to be well informed, sophisticated buyers of telecommunications services that derive significant bargaining power from the high volume of services they purchase, their awareness of competitive alternatives, and their abilities to self-provision access services. For example, WorldCom's acquisitions of MFS, Brooks Fiber, and most recently MCI enabled it to not only self-provision access services but to impose a significant competitive constraint in the access markets – allowing MCI WorldCom to advertise a "local-to-global-to-local" network for business customers. Likewise, AT&T initiated self-provision of access by constructing local fiber facilities in various MSAs. More recently, it accelerated the process by acquiring TCG and announcing the proposed acquisition of TCI, a provider of cable TV services – processes by which AT&T hopes to "reduc[e] … our dependence on the Bell companies for direct connections to business[12] and "operate the nation's most extensive, broadband local network platform."[13] AT&T has further committed to a total bypass of local exchange providers' facilities in its recently announced joint venture with cable provider Time Warner. Its CEO, C. Michael Armstrong, stated that "together with our merger with [TCI] and agreements with five TCI affiliates, the Time Warner joint venture will enable AT&T to reach more than 40

12 "AT&T Completes TCG Merger; TCG Now Core of AT&T Local Services Network Unit," *AT&T Press Release*, see <http://www.att.com/press/0798/980723.chb.html>, July 23, 1998.

13 "AT&T and TCI To Merge, Create New AT&T Consumer Services Unit," *AT&T Press Release*, see << http://www.att.com/press/0698/980624.cha.html>>, June 24, 1998.

percent of U.S. households over the next four to five years."[14] AT&T is also reported to be in talks with additional cable providers to further extend its coverage to more than half the country.[15] Hence, customer awareness of and knowledge about alternative suppliers of access is very high and, indeed, the fact that the primary competitive alternative for these large vertically integrated customers is now self-supply indicates that customers clearly have no informational barriers to switching providers.

As I have indicated, our analysis will follow the Merger Guidelines' approach of assessing actual and potential competition. To assess the extent of actual competition, we examine Ameritech's market shares of special access and dedicated transport, as well as Ameritech's share of market growth. I explain in Section IV.B. why the latter measure is likely to better reflect the extent of actual competition in markets that are undergoing deregulation, and provide a good indicator of the ease of entry. Even the share of growth may be a crude measure of actual competition, however, because it only assesses the actual customer base of providers, not their capacity to quickly provide services to additional customers. A measure of this capacity to expand to additional customers is the amount of competitive fiber in the incumbent's wire center serving areas. The existence of fiber in the ground is an excellent indicator of competition because, as will be explained in more detail below, any carrier that is present in a particular wire center serving area need make little (if any) sunk investment to serve any and all customers served by that wire center, and can do so almost immediately. Indeed, as long as a customer can be reached by an offshoot of a competitor's fiber backbone within some reasonable time frame (two years in the Merger Guidelines) and expect to recover the cost of its investment and expenses, potential entry is viable and enforces a competitive discipline.

Finally, a powerful measure of competitors' presence specifically in the market for dedicated transport for switched access is operational collocation in Ameritech's central offices. If a competitor has operational collocation in Ameritech's central office, it almost always has fiber to that CO and therefore is providing, or can provide, dedicated transport for switched access.

In the Chicago LATA, the fiber routes of competitors are quite extensive and competitors' market shares are so high as to pass the standard rules of thumb in antitrust analysis for non-dominance. Hence, the forbearance case in Chicago can be made primarily on the basis of actual rather than potential competition. For this reason, a detailed analysis of the costs and speed of potential build-outs from competitors' existing networks in Chicago is not necessary and has not been conducted.

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14 *AT&T Press Release*, "AT&T and Time Warner form strategic relationship to offer cable telephony," February 1, 1999.

15 Bartash, Jeffry, "AT&T, Time Warner in phone deal," *CBS MarketWatch.com,* February 1, 1999 (see << http://cbs.marketwatch.com/archive/19990201/news/current/telecom.htx?source= blq/yhoo&dist=yhoo >>.

## III. IMMEDIATE FORBEARANCE IS NECESSARY FOR CUSTOMERS TO RECEIVE THE FULL BENEFITS OF COMPETITION IN THE CHICAGO AREA HIGH-CAPACITY ACCESS MARKET

When competition in a market is sufficient to constrain market power, it is both unnecessary and undesirable to impose artificial pricing restrictions on participants in the market. It is unnecessary because markets function more effectively than can regulations to protect customers. More important, it is undesirable because artificial pricing restrictions are not innocuous in competitive markets. By artificially preventing providers from raising, lowering, restructuring, targeting, bundling, or otherwise changing prices, providers are prevented from responding to differential cost conditions, to customer-specific demands and preferences, and to changing market conditions. If Ameritech cannot price in response to these legitimate market factors, Ameritech is straightjacketed in its ability effectively to meet customer demand, and customers suffer. Moreover, by requiring Ameritech to signal its moves by filing notice of price changes 15 days in advance, Ameritech is discouraged from decreasing prices. This dampens competition and harms customers. In this section, I describe the impact of pricing regulation on high-capacity access customers, and the competitive advantages the CLECs derive from the asymmetry of this regulation. I explain why full pricing flexibility is not only warranted in the Chicago market, but is in the public interest. Regulatory oversight in Chicago now serves as an impediment to the efficient functioning of the market rather than a safeguard for customers.

Under the FCC mandated zone-pricing rules, Ameritech is permitted to specify three zones, where the zone to which any particular wire center is assigned is "based upon the traffic density of the area serviced by that central office."[16] Exhibit 1 shows the rate zone designations by wire center on the map of LATA 358, the Chicago LATA. Within each state of Ameritech's five-state region, Ameritech is permitted to differentiate its rates to customers across zones but must maintain a consistent rate to all customers within a zone. Zone 1 areas are those with the greatest Ameritech traffic density, whereas Zone 3 areas are those with the lowest traffic density.

The zone-pricing structure for special access represents an attempt to allow some pricing flexibility to "reasonably reflect cost-related characteristics," such as on the basis of traffic density.[17] While it is true that density is a determinant of cost, it is clearly not the only cost driver. Costs also depend on the length of the facilities, the type of facilities (fiber vs. copper), the way the facilities are constructed (aerial cables, buried cable, or underground cable in conduit), the type of area into which the facilities are deployed (established urban vs. new development), and the specific combination of services

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16 Federal Communications Commission, *In the Matter of Expanded Interconnection with Local Telephone Company Facilities*, Request for Approval of the Special Access Rate Zone Plan for the Ameritech Operating Companies, CC Docket No. 91-141, p. 1.

17 47 C.F.R. § 69.123. See also Federal Communications Commission, *In the Matter of Ameritech Operating Companies Zone Density Pricing Plans*, DA 93-869, ¶ 2.

desired by the customer, among other factors. Mandating uniform pricing significantly limits an incumbent's ability to respond to cost differentials and competitive inroads within that zone. A competitor, recognizing specific areas of high demand or low costs within the zone, can target those customers with low prices, while the incumbent cannot compete with those prices without decreasing the prices to all customers. The result is that the incumbent either cannot compete effectively for those customers, which directly harms those customers, or the incumbent prices too low to customers in other areas, relative to their costs. Removing the provider from the straightjacket of uniform pricing permits a more economically rational and competitively vigorous pricing structure.

In addition to the simple fact of cost variation within zones, Ameritech is further constrained from responding to cost variations across zones with in the same designation in different parts of the state. For example, the price Ameritech charges a Zone 2 customer in the north side of Chicago must correspond with the Zone 2 price it charges to a customer, say, in Springfield. Moreover, a significant omission from the zone assignment criteria established by the FCC is the *competitors'* traffic density in a particular area; traffic density in a central office area is based on Ameritech traffic only. Both of these attributes of zone pricing have a negative impact on Ameritech's customers and constrain Ameritech's ability to compete effectively in the Chicago LATA market. By disregarding certain zone-specific attributes, such as the extent of CLEC and IXC participation, zone-pricing flexibility is an imperfect instrument by which to promote access competition. Zone-pricing regulation prevents Ameritech from differentiating its prices when competing in zones where competitors have significant traffic density and, presumably, the fiber capacity with which to easily absorb Ameritech's traffic.

Zone-pricing restrictions have a further significant and injurious effect on Ameritech's customers. Unlike its competitors, Ameritech is forbidden from setting prices on an individual customer basis ("ICB Pricing") to reflect each customer's specific demand characteristics. For example, Ameritech is forbidden from differentiating its pricing to customers based on their expected growth in demand for high-capacity access services.[18] Expected growth affects the costs of serving a customer for reasons similar to the reasons that volume and term commitments affect the costs: they affect the risks that the provider accepts when it installs facilities and it affects the provider's decisions regarding how to configure the facilities being provided. Ameritech's zone pricing restrictions constrain Ameritech from reflecting these legitimate economic factors in its prices to individual customers.

[18] Ameritech is able to set service plan discounts based on term and/or volume discounts. However, the FCC has indicated that the size of the discounts cannot be structured to reflect growth, i.e., the discount cannot be based on, say, the customer achieving a usage yardstick within a predetermined time frame. For example, if a customer purchases $500 of services for a given six-month period, the seller's offer of a five percent discount on the buyer's purchase for the next three-month period if the buyer committed to purchasing $520 of services during that time would be considered a growth discount. See Federal Communications Commission, *Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry*, FCC 96-488, December 23, 1996, ¶ 192.

Finally, zone-pricing regulation constrains Ameritech's ability to offer innovative service packages, such as bundling its high-capacity access services together on an ICB basis, as its competitors are permitted to do. Ameritech is unable to compete with other providers in response to requests for proposals ("RFPs"), for example, by putting together a tailored package of high-capacity services and pricing according to the specific characteristics of the customer's desired configuration. By limiting Ameritech's ability to compete in this way, customers are harmed because their choices are limited. Customers should not be denied the opportunity to benefit from Ameritech's valuable skills, experience, and efficiency in the provision of high-capacity services.

How would Ameritech's prices respond, were zone-pricing restrictions to be removed? One response would likely be an elimination of price averaging across all customers within a zone; prices would tend to adjust to accurately reflect individual customers' desired service configurations and costs of service. While some prices would decline, others might increase. Such an outcome is how a competitive, efficiently functioning market behaves. Efficiency is achieved, and the public interest is served, when market participants receive the proper signals as to how much to consume and whether to initiate or forgo entry. The ability to tailor its high-capacity service offerings on an individual-customer basis would endow Ameritech with the ability to differentiate its service offering in a manner that customers demand and would enable Ameritech to compete effectively in the high-capacity market on an even footing with its unregulated competitors, to the benefit of customers.

In addition to the zone pricing restrictions that Ameritech bears under dominant carrier regulation, Ameritech is required to provide 15 days' notice of price changes, with cost support. Aside from the unnecessary waste of valuable resources to produce such supporting cost studies, the advance filing requirement has an insidious and detrimental effect on competition. When a provider is required to signal to its competitors when it is going to reduce prices, it loses much of the benefit of the planned price reduction. Competitors who are warned of the reduction have an opportunity to match the price reduction and be the first to approach customers with it. Indeed, those customers who are most desirable will be targeted first by the competitors, leaving the higher cost customers or otherwise less profitable customers for the incumbent. Anticipating this inevitable outcome, incumbents have a dampened incentive to compete by decreasing prices. Any prices reductions by the incumbent are likely to be reactive, rather than proactive. At the same time, competitors need not be on guard against unanticipated competitive price reductions by the incumbent, since they know that they will have plenty of advance warning. This may make competitors less diligent and less proactive in their own competitive strategies. Both effects harm customers because they weaken the providers' incentives to compete aggressively on price.

## IV. COMPETITIVE CONDITIONS IN THE CHICAGO LATA

Competitors providing high-capacity services in the Chicago LATA comprise a variety of firms, including companies with large financial resources that are well-established in the Chicago market. The past success of these competitors is evidenced by their large market shares. As I will further show, the IXCs' and CLECs' extensive fiber networks already in the ground and pervasive collocation in Ameritech's wire centers show that these competitors are in a committed position to take even larger shares of this market. This description of the competitive conditions in the Chicago market includes profiles of the leading competitors, evidence that Ameritech's competitors now command substantial market shares, and indications that these competitors are well-positioned and committed to further expanding their competitive activity.

### A. MARKET PARTICIPANTS

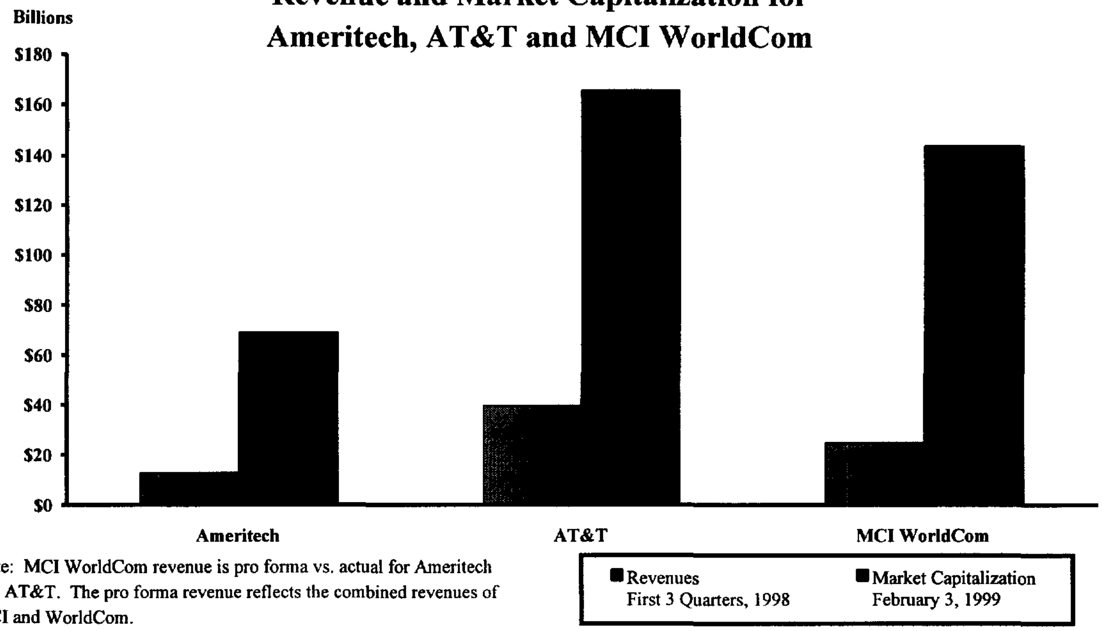
Competitive providers of high-capacity services in the Chicago LATA include the most established and experienced competitive access providers (CAPs) in the industry – TCG and MFS. These CAPs have been absorbed into AT&T and MCI WorldCom, firms that dwarf Ameritech in financial size and which bring substantial networks, expertise, and customer relationships to bear on the high-capacity services market. In this market, there are also smaller wireline players that are targeting small and medium-size business customers, and alternative competitors that are using (and developing) advanced wireless and IP-based networks.

#### 1. The Major Competitors

A look at the relative revenues and market capitalizations of Ameritech, MCI WorldCom, and AT&T illustrates that Ameritech is competing against firms with enormous financial resources.

## Figure 1

### Revenue and Market Capitalization for Ameritech, AT&T and MCI WorldCom




Note: MCI WorldCom revenue is pro forma vs. actual for Ameritech and AT&T. The pro forma revenue reflects the combined revenues of MCI and WorldCom.

*Sources: Bloomberg; Financial Markets, Commodities, News, February 3, 1999. Revenues from company Third-Quarter SEC Forms 10-Q.*

Along with their financial size, AT&T and MCI WorldCom have established customer relationships with most large businesses, and they are recognized as industry leaders with enormous brand name equity. These attributes would make these firms formidable competitors, even had they not combined with the largest, best-known and established CAPs in the Chicago market. Indeed, TCG was the country's first and largest provider of competitive local telecommunications services.[19]

The large IXCs' combinations with MFS and TCG changed the competitive picture in two ways. First, MFS and TCG worked with business customers and carriers over the course of several years to educate the market about the ability to purchase high quality, high-capacity service from companies other than Ameritech. In fact, these firms won a large portion of the market prior to combining with AT&T and MCI WorldCom. Second, AT&T and MCI WorldCom are two of the largest *purchasers* of high-capacity services. Surely, these firms will continue to migrate their high-capacity traffic onto the networks that they now own. Analysts have projected that MCI WorldCom is capable of self-provisioning more than 70% of its access services – a figure that may grow to 90%.[20]

Nationwide, MCI WorldCom commands an impressive network, both in scale and geographic scope. MCI WorldCom has boasted that its network is capable of carrying all

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19 Teleport Communications Group, Inc. Fact Sheet, see <<http://www.tcg.com>>.

20 "WorldCom, Inc. Company Report," Salomon Smith Barney, April 9, 1998.

the data traffic of every other carrier, combined,[21] calling themselves the "carrier's carrier."[22] Ron McMurtrie, MCI WorldCom's vice president of marketing, claims that the company can reach approximately 75 percent of North American-based businesses with its own network.[23] The business press has noted that "[MCI WorldCom] is likely to become the biggest threat to the Baby Bells in the $100 billion local telephone market...[W]ith Brooks Fiber and MCI's nascent local business, it will leapfrog other long-distance carriers into local calling. What's more, it avoids access charges by using its own local connections."[24]

In the Chicago market, MCI WorldCom controls an extensive network with 225 route miles of fiber, and has connected approximately 400 buildings to its greater Chicago-area network, including the Sears Tower.[25] Its fiber presence is dense in Chicago's central business district (where the majority of its largest customers reside) and stretches to the suburbs from there. Quality Strategies describes MCI WorldCom's Chicago network architecture as the composite of three distinct pieces:[26]

*(i)* Downtown – consisting of the area east of Interstate 90 to Lake Michigan. Within this area, MCI WorldCom has nearly universal coverage;

*(ii)* Northern suburbs – starting from O'Hare International Airport into Lake County. MCI WorldCom is capable of offering services to customers in the following northern suburban municipalities: Northbrook, Deerfield, Schaumburg, Des Plaines, Rolling Meadows, Elk Grove Village, O'Hare International Airport, Wheeling, and Glenview; and

*(iii)* Western suburbs – beginning at the central business district and extending to Downers Grove and Naperville. MCI WorldCom is capable of offering services to customers in the following western suburban municipalities: Cicero, Oakbrook, Downers Grove, Naperville, and Darien.

In the Chicago market, AT&T's network consists of approximately 1,000 route miles, passing through the city's central business district and the vast majority of densely

21 *MCI WorldCom Press Release*, "MCI WorldCom On-Net Rewrites the Rules for Communications, September 28, 1998.

22 Advertising Supplement to the Wall Street Journal, October 1, 1998.

23 Van, Jon, "MCI WorldCom Pushes Voice, Data Service, Awaits Wireless Opportunity," *Chicago Tribune*, January 18, 1999, p. C2.

24 Peter Elstrom, "The New World Order." *Business Week*, October 13, 1997.

25 MCI WorldCom: U.S. Operations Fact Sheet, see <<http://www.mciworldcom.com>>; see also Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5).

26 Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5).

populated, business-intensive suburbs.[27] Quality Strategies describes AT&T's Chicago network architecture as follows:

> *AT&T Local's serving area is similar to that of MCI WorldCom; however, AT&T Local's is far more expansive. Like MCI WorldCom, AT&T Local's fiber presence is most dense in Chicago's central business district. Fiber travels beneath several of "The Loop's" most prominent thoroughfares, including Wacker Drive, Dearborn Street, and Randolph Street. Currently, there are very few areas in the greater Chicago area that AT&T Local is not capable of serving. Its fiber presence is particularly dense in the northern suburbs in that these were among the first targeted for expansion several quarters ago.*[28]

In the northern portion of the Chicago market, AT&T has installed fiber in the following metropolitan areas: Skokie, Wilmette, Evanston, Highland Park, Des Plaines, Norridge, Schaumburg, Northbrook, Deerfield, Waukegan, Rolling Meadows, Elk Grove, and Hoffman Estates.[29] To the west of Chicago, AT&T has facilities to serve the following communities: Joliet, Oakbrook, Cicero, Downers Grove, Lemont, Geneva, Summit, and Wheaton.[30] Furthermore, AT&T's network extends directly to the south of Chicago, where fiber passes through the following suburban communities: Alsip, Palos Hills, Evergreen Park, Blue Island, and Gary and Hammond, Indiana.[31]

### 2. Smaller Wireline Competitors

Not all competitors are behemoths. Smaller competitors are important to the composition of the competitive market, especially with strategies that extend competition for the small and medium-sized business customers.

NextLink Communications launched services in Chicago in February 1998, offering a full array of telecommunications services.[32] NextLink offers local service, long distance, group communications toolboxes (single-number fax, pager, and call forwarding services), voice mail, dedicated lines, and high-capacity services to its primarily small and medium-sized business customers in Chicago.[33] It issued an initial public offering in

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27 Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5).

28 Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5).

29 Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5).

30 Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5).

31 Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5).

32 NextLink: Cities We Serve-Illinois, see <<http://www.nextlink.net>>.

33 NextLink: Cities We Serve-Illinois, see <<http://www.nextlink.net>>.

September 1997, and today has a $1 billion market capitalization.[34] The company now claims to have 110 route miles of fiber serving the Chicago LATA (358).[35] Based on information of industry analysts, Quality Strategies states that NextLink has installed fiber beneath the following streets in Chicago's central business district: Wacker Drive, LaSalle Street, Wabash Avenue, and Michigan Avenue. Finally, Quality Strategies cites NextLink representatives as stating that the company can now serve the Chicago LATA but does not intend to expand beyond this area for the next two years.[36]

Founded in April 1997, Allegiance Telecom offers small and medium-sized businesses a complete package of telecommunications services, including local, long distance, international calling, high-speed data transmission, and Internet services.[37] After its initial public offering in July 1998, it has achieved a $1.2 billion market capitalization.[38] Under the direction of Royce Holland, former president and co-founder of MFS Communications, the carrier has targeted 24 metro areas in the United States. The company currently serves Chicago, Atlanta, Dallas, and New York and plans to launch service in four other cities by the end of 1998.[39]

Allegiance describes its unique entry strategy as follows:

> *Under its "smart build" strategy, Allegiance plans to deploy digital switching platforms with local and long distance capability and initially lease fiber trunking capacity from the ILECs and other CLECs to connect the Company's switch with its transmission equipment collocated in ILEC central offices. Allegiance will lease unbundled copper loop lines and high-capacity digital lines from the ILECs to connect the Company's customers and other carriers' networks to the Company's network. Allegiance plans to lease capacity or overbuild specific network segments as economically justified by traffic volume growth.* (Allegiance 10Q, August 12, 1998)

### 3. Wireless High-Capacity Service Competitors

Wireless providers offer another alternative that has important implications for growing competition in less dense areas. To date, the wireless providers appear to focus mainly

34 Initial Public Offering and market cap information was obtained from *Bloomberg; Financial Markets, Commodities, News*, February 2, 1999.

35 Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5).

36 Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5).

37 "Allegiance Telecom Initiates Service in Chicago Metro Area," *Allegiance Telecom Press Release*, see <<http://www.allegiancetele.com>>, September 2, 1998.

38 Initial Public Offering and market cap information was obtained from *Bloomberg; Financial Markets, Commodities, News*, February 2, 1999.

39 "Allegiance Telecom Initiates Service in Chicago Metro Area," *Allegiance Telecom Press Release*, see <<http://www.allegiancetele.com>>, September 2, 1998.

on small and medium-sized business customers. WinStar and Teligent are the notable wireless competitors providing high-capacity service in Chicago.

WinStar Communications became the first company in the Chicago area to provide wireless dedicated and switched, wholesale and retail telecommunications services in early 1997.[40] It went public in 1991, and currently has a $1.8 billion market cap.[41] With up to $2 billion in financing provided by Lucent Technologies, WinStar plans to extend its network.[42]

In Chicago, WinStar began reselling Ameritech local exchange services shortly following passage of the Telecommunications Act of 1996 and has now converted many of these customers to its own facilities.[43] In April 1997, it launched its facilities-based offerings with the installation of a Lucent 5ESS switch and, as of year-end 1997, approximately 25 rooftop transmission facilities.[44] In1998, the company announced that it completed the integration of its voice and data networks[45] and had transmission facilities installed on 125 Chicago rooftops. WinStar advertises itself as a provider of switched and dedicated access services.[46] One of WinStar's major distribution facilities in the Chicago area is the LaSalle-Wacker Building, where it has established an antenna farm of 70 small units. Additionally, WinStar has attached antennas to the roofs of several other prominent Chicago high-rises, including the Sears Tower and Merchandise Mart. Its current serving area includes the majority of the city of Chicago and the following surrounding communities: Bensenville, Downers Grove, Northbrook, Oak Brook, and Oak Brook Terrace.

Teligent, which is headed by former AT&T president Alex Mandl, went public in November 1997 and currently has a market capitalization of approximately $2 billion.[47] It

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40 Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5).

41 Initial Public Offering and market cap information was obtained from *Bloomberg; Financial Markets, Commodities, News*, February 2, 1999.

42 "WinStar Reports Third Quarter Results," *WinStar Communications Press Release*, see <<http://www.winstar.com>>, November 5, 1998. "$2 Billion WinStar/Lucent Agreement to Expand WinStar's Broadband Network," *WinStar Communications Press Release*, see <<http://www.winstar.com>>, October 22, 1998.

43 The following statistics on WinStar's Chicago network, except were indicated, have been taken from Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5).

44 "WinStar – 'The New Phone Company' – Debuts in Chicago," *WinStar Communications Press Release*, see <<http://www.winstar.com>>, April 3, 1997.

45 "WinStar Providing Local Number Portability in 15 Major Markets," *WinStar Communications Press Release*, see <<http://www.winstar.com>>, September 9, 1998.

46 See <<http://www.winstar.com>>.

47 Initial Public Offering and market cap information was obtained from *Bloomberg; Financial Markets, Commodities, News*, February 2, 1999. This market capitalization includes both Class A (publicly traded) shares and Class B shares (held by Nippon Telegraph and Telephone, The Associated Group and Telecom Ventures), which carry special voting privileges. If only Class A shares are included, Teligent has a market capitalization of approximately $313 million.

has thus far targeted small and medium-sized businesses and offers wireless local, long-distance, high speed data, and dedicated Internet services.[48]

The company launched services in Chicago in October 1998. Quality Strategies describes the company's strategy as follows:

> *Teligent can provide each customer with two-way data transfer rates up to 20 Mbps, which is significantly more than the 1.5 Mbps capacity currently available on conventional T-1 lines. A single Teligent base station is designed to provide 200 T-1 lines, the equivalent of 4,800 dedicated telephone lines, while each building's radio/antenna unit will be initially designed to provide up to 13 T-1 lines or 312 dedicated telephone lines.*[49]

Comparable to WinStar, Teligent utilizes a wireless, digital network to connect directly with customers, thus bypassing the facilities of incumbent carriers.[50] Teligent's wireless network gives it a lower cost structure than its competitors that are using traditional facilities.[51] The company is using these savings to attract customers with competitively priced bundled services.

We now turn to an analysis of the quantitative evidence of the competitive strength of the players that I have just profiled, in the provision of high-capacity access services in the Chicago LATA. To fully appreciate the relevance of some of these measures, it is necessary to understand the basics of how high-capacity special access, and high-capacity dedicated transport for special access, are provisioned. Readers unfamiliar with the mechanics of access provisioning are invited to turn to the Appendix for a brief overview.

48 "Teligent Launches Service in First Ten Markets, Vows to Start a Communications Revolution," *Teligent Press Release*, see <<http://www.teligentcorp.com>>, October 27, 1998.

49 Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5).

50 Peter Haynes, "Teligent's Test," *Forbes Magazine*, see <<http://www.teligentcorp.com>>, March 9, 1998.

51 Peter Haynes, "Teligent's Test," *Forbes Magazine*, see <<http://www.teligentcorp.com>>, March 9, 1998. See also Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5). Interestingly, Quality Strategies indicates two distinct advantages of Teligent's wireless network over that of WinStar: (i) Teligent's network is built on a point-to-multipoint technology whereas WinStar's is point-to-point. *"A wireless point-to-multipoint broadband network allow transmissions between multiple customer antennas and a single base station antenna, thereby allowing Teligent to share the same spectrum among its customers and reducing its capital expenditures."* (ii) Teligent is licensed to provide its service at a frequency of 24 GHz, whereas WinStar is licensed at the 38 GHz frequency. *"This lower frequency can transmit a line of sight signal approximately 3 miles – twice as far as WinStar's 38 GHz technology. Obviously, this gives Teligent twice as much network reach with the same capital investment."* Quality Strategies, *Ameritech CAP/CLEC Chicago Network Descriptions*, Third Quarter, 1998 (Exhibit 5). Also see "Teligent Announces First Call Over Commercially Available 'Point to Multi-Point' Wireless Equipment from Nortel (Northern Telecom)," *Teligent Press Release*, <<http://www.teligentcorp.com>>, March 18, 1998.

### B. MARKET SHARE

Market shares should be measured in the way that best reflects the firms' future competitive significance in the market.[52] In today's high-capacity services market, with rapid growth of competition, static measures of revenue or customer shares understate the extent and effect of competition. In our view, geographic regions or LATAs where competition is significant in terms of the available capacity and capability of competitors, but less obvious in terms of actual market share, are good candidates for highly detailed geographic analysis of the ability of entrants to serve the incumbent's customers. Markets in which the entrants have already made significant inroads and in which the inroads are geographically dispersed throughout the region do not require the same level of geographic investigation. The Chicago area falls in the latter category. Competition in the Chicago LATA is so significant and geographically pervasive throughout the areas where high-capacity demand exists that a detailed study of the fiber maps of the entrants, and their ability to serve individual customers, is simply not warranted. The FCC will be able to determine that Chicago is robustly competitive without that level of analysis.

#### 1. Competitors Are Already Established

Competitors have made rapid and significant inroads into the Chicago market. By far, most customers in the Chicago LATA do not buy special access from Ameritech. As of the most recently available figures, Ameritech is the retail provider of special access for only 6% of special access customers.[53]

The carrier that is the retail provider to a customer is the provider that has the customer relationship and bills the customer. That provider is the one that the customer works with to order the service, handle questions, and provide customer service and support. It is considered enormously valuable to have the retail relationship with the customers in the provision of high-capacity services. There are at least two reasons for this. First, as I explained earlier, most of the access providers in the market today are diversified IXCs who provide an array of telecommunications services in addition to special access. The carrier with the customer relationship for access has the opportunity to sell a variety of services, often bundled, to the customer. Hence, providing access is a gateway to many other profit opportunities for competitors, and the market share figures speak for themselves that Ameritech has virtually lost this market. Ameritech is no longer an important player at the retail level.

The second reason that having the customer relationship is important is because it limits any market power Ameritech might otherwise have had in the wholesale market. Suppose Ameritech were the underlying supplier of special access, either the dedicated transport or the LDC piece, to a customer, and MCI WorldCom were reselling the service as the retail provider to the customer. Now suppose that Ameritech tried to increase the

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52 *Merger Guidelines*, §1.41.

53 Data provided by Ameritech.

wholesale price to MCI WorldCom. One of MCI WorldCom's options would be to extend its own facilities to that customer and strand Ameritech's facilities. The fact that MCI WorldCom already has that customer means that this change could be made almost transparently to the customer, and would not require the customer to shop for a new provider or change providers.

The recent mergers of the largest IXCs and CAPs, such as AT&T and TCG, and MCI and WorldCom/MFS, ensures that IXCs can self-supply special access to many customers. In fact, the projected access cost savings were touted as an important factor in the mergers. Financial analysts described AT&T's merger with TCG as "dramatically minimiz[ing] AT&T's need to use RBOC networks"[54] and as allowing AT&T to "immediately benefit in each of TCG's markets, primarily in terms of access charges and local transport."[55] The magnitude of these effects is difficult to overstate; Prudential Securities estimated that migrating AT&T's traffic onto TCG's networks would save AT&T $550 million - $750 million in access charges in 1999 alone.[56]

The retail market share indicates more than simply the power of IXCs' and CLECs' retail customer relationships. It indicates the ease with which these competitors will be able to further extend their market and invest in facilities in the future. The common business plan of competitors (as described by both TCG's and WorldCom's 1997 Forms 10K) is to develop a customer base by providing services as a reseller or by using Ameritech's LDC facilities, and then to build out when the revenue base is established and the risks are limited. The current providers in the Chicago area have shown that build-out can be done quickly. The fact that these competitors control the customer relationships virtually throughout the market means that they are poised to provide facilities, at little risk, if Ameritech were to attempt a wholesale price increase. Indeed, they presumably will build out in any event, as they already have done to a great extent.

Where a competitor is the retail provider and has the customer relationship, the competitor may or may not provide the service over its own facilities, as I have already indicated. In some cases, the underlying provider of all or part of the service is Ameritech. Market share of special access facilities is defined to address the possible concern that, even if a carrier is providing its own dedicated transport to Ameritech's central office, Ameritech may exercise market power if it owns the LDC from the CO to the end-use customer. Hence, to address this concern, the special access market share of a particular carrier is defined as the share of special access customers it serves *via its own LDCs*, relative to the total number of special access customers (measured in DS1 equivalent LDCs). The transport market share measures the share of facilities-based provision of dedicated transport. It is measured in terms of DS1 equivalent entrance facilities, regardless of whether the dedicated transport being provided is for switched or special access traffic.

54 Solomon Smith Barney, Grubman/McMahon, January 9, 1998.

55 Donaldson, Lufkin & Jenrette, Timothy N. Weller, January 9, 1998.

56 "AT&T Company Update," Prudential Securities, January 21, 1998.

Table 1 indicates the market share of Ameritech for the underlying facilities for the most recently available figures, which are already a year old. The LDC figures are for the entire high-capacity market. Market shares for dedicated transport are developed by Quality Strategies for the city of Chicago and the Chicago suburbs separately. "Chicago city" refers to the Chicago city limits, and "Chicago suburban" refers to the entire Chicago MSA, minus the city of Chicago.

**Table 1:**
**Chicago MSA Market Shares (DS1 Equivalents):**
**First Quarter 1998**

| | **Special Access LDCs** | **Dedicated Transport (Chicago City)** | **Dedicated Transport (Chicago Suburbs)** |
|---|---|---|---|
| Ameritech | 51.5% | 52.0% | 72.2% |
| CLECs | 48.5% | 48.0% | 27.8% |

*Source: Quality Strategies, Ameritech Chicago HICAP Track Report, First Quarter 1998 (Exhibit 8).*

Economists and the courts recognize that market share is only a starting point for assessing market power or, as the courts, term it, "monopoly power."[57] However, rules of thumb have emerged for evaluating whether a firm's market share is high enough to raise concern or warrant further analysis. In particular, "courts virtually never find monopoly power when market share is less than about 50%,"[58] and even for shares above this level, the courts generally require additional evidence for a finding of monopoly power.

57 Market power traditionally has been defined by the courts as "the power to control market prices or exclude competition." (United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 391 (1956)) Establishing that a provider has no monopoly power in this sense is equivalent to establishing the FCC's criteria for "sufficient competition."

58 ABA Section of Antitrust Law, *Antitrust Law Developments* (4th ed. 1997), p. 236. The ABA cites the following cases as supporting the above assertion: Blue Cross & Blue Shield United v. Marshfield Clinic, 65 F.3d 1406, 1411 (7th Cir. 1995) ("50 percent is below any accepted benchmark for inferring monopoly power from market share"), *cert. denied*, 116 S. Ct. 1288 (1996); U.S. Anchor Mfg. v. Rule Indus., 7 F.3d at 1000 (11th Cir. 1993), ("we have discovered no cases in which a court found the existence of actual monopoly established by a bare majority share of the market"), *cert. denied*, 114 S. Ct. 2710 (1994); Fineman v. Armstrong World Indus., 980 F.2d 171, 202 (3d Cir. 1992) ("As a matter of law, absent other relevant factors, a 55 percent market share will not prove the existence of monopoly power."), *cert. denied*, 507 U.S. 921 (1993); Holleb & Co. v. Produce Terminal Cold Storage Co., 532 F.2d 29, 33 (7th Cir. 1976) (dictum) (60% market share insufficient); Twin City Sportservice, Inc. v. Charles O. Finely & Co., 512 F.2d 1264, 1274 (9th Cir. 1975) (50% market share insufficient), *cert. denied*, 459 U.S. 1009 (1982); White Bag Co. v. International Paper Co., 579 F.2d 1384, 1387 (4th Cir. 1974) (referring to tabulation of cases in Hiland Dairy v. Kroger Co., 402 F.2d 968, 974 (8th Cir. 1968 ) (showing monopoly power found only when shares of relevant market are 70% or more), *cert. denied*, 395 U.S. 961 (1969)); Cliff Food Stores v. Kroger, Inc., 417 F.2d 203, 207 n.2 (5th Cir. 1969) (indicating that something more than 50% of the market is a prerequisite to finding a monopoly"); Re/Max Int'l, Inc. v. Realty One, Inc., 924 F. Supp. 1474, 1490-95 (N.D. Ohio

The market shares for Ameritech's special access facilities, therefore, fall within the safety zone described by courts for determining monopoly power. Even without the powerful additional evidence to follow describing the decline in Ameritech's share of the market growth and the ubiquity of competitors' fiber, the market share evidence alone is sufficient under accepted standards to find that sufficient competition exists to grant forbearance under Section 10(a).

The market share for dedicated transport in the city is also within the safety zone in which market shares are generally sufficient, without additional evidence, to conclude that no market power exists. A market share of 72.2% in the suburbs is one that might cause concern if the other competitive factors in the market were unfavorable, but as I will show in Section C, the evidence on collocation demonstrates that competitors already have facilities in place to serve a substantial majority of Ameritech's switched access minutes, including those in the suburbs. The trends in the market and the success of competitors show that competitors are not facing entry barriers in dedicated transport, and therefore they impose significant competitive pressure on Ameritech.

Moreover, it is likely that these statistics underestimate the IXCs' market shares, for several reasons. First, as I have indicated, these numbers are already a year old and Ameritech's market share is declining in both special access and dedicated transport. Second, the methodology used by Quality Strategies for estimating market shares involved asking the competitive carriers to voluntarily disclose their facility counts, while Quality Strategies had direct access to Ameritech's facilities data. IXCs have an incentive to under-report their facilities, particularly those that provide special access by

1996) (39% to 51% market shares insufficient); Advanced Health-Care Servs. v. Giles Mem'l Hosp., 846 F. Supp. 488, 493-94 & n.9 (W.D. Va. 1994) (absent extraordinary circumstances, market share over 50% required); AT&T v. Delta Communs. Corp., 408 F. Supp. 1075, 1106 (S.D. Miss. 1976) (less than 50% market share insufficient), *district court opinion adopted and aff'd per curiam*, 579 F.2d 972 (5th Cir. 1978), *modified on other grounds*, 590 F.2d 100, *cert. denied*, 444 U.S. 926 (1979); *see also* Colorado Interstate Gas Co. v. Natural Gas Pipeline Co., 885 F.2d 684, 694 n.18 (10th Cir. 1989) (dictum) ("While the Supreme Court has refused to specify a minimum market share necessary to indicate a defendant has monopoly power, lower courts generally require a minimum market share of between 70% and 80%."), *cert. denied*, 498 U.S. 972 (1990). Cases holding such market shares sufficient to evidence monopoly power include: Arthur S. Langenderfer, Inc. v. S.E. Johnson Co., 917 F.2d 1413, 1443 (6th Cir. 1990) (58% share of pricing contracts over seven-year period sufficient), *cert. denied*, 502 U.S. 808 (1991); Hunt-Wesson Foods, Inc. v. Ragu Foods, Inc., 627 F.2d 919, 926 (9th Cir. 1980) (where market share had been increasing, 65% market share could justify inference of monopoly power), *cert. denied*, 450 U.S. 921 (1981); Pacific Coast Agric. Export Ass'n v. Sunkist Growers, 526 F.2d 1196, 1204 (9th Cir. 1975) (upholding jury finding of monopolization of Hong Kong orange export market where market share ranged from 45% to 70% and there was other evidence of monopoly power), *cert. denied*, 425 U.S. 959 (1976); Reazin v. Blue Cross & Blue Shield, 663 F. Supp. 1360, 1416-1418, (D. Kan. 1987) (60% market share sufficient), *aff'd in pertinent part and remanded in part*, 899 F.2d 951 (10th Cir.), *cert. denied*, 497 U.S. 1005 (1990).

completely bypassing Ameritech's network and central offices.[59] Moreover, we know that to the extent that either AT&T or MCI was engaged in self-supply before their respective CAP mergers, none of that self-supply was captured in Quality Strategies' studies.

Third, the Quality Strategies' market share quoted above are based on physical facilities, not on revenue. Competitive entrants into any previously-regulated market routinely and rationally target the highest revenue customers and areas first, and proceed in order of predicted profitability. Hence, facilities-based market shares tend to systematically underestimate competitors' revenue-based market shares, and overestimate the incumbent's. The same is almost surely the case here as well. Ameritech's reported market share should be viewed as an upper bound.

Finally, as I indicated earlier, the fact that Ameritech has virtually no customer relationships with high-capacity special access customers limits its market influence further. For this reason, Ameritech's facilities market share would tend to overestimate Ameritech's potential to affect the market.

Like the market share for special access LDCs, the market share of dedicated transport also likely understates the competitors' market shares, for a number of reasons. First, as in the case of special access, IXCs are likely to underreport their self-provisioned facilities. Given the statements of the IXCs cited earlier in this report, the amount of self provisioning is likely to be substantial, and the capacity for self-provisioning even greater. The market shares are measured on the basis of actual service, not capacity to serve. If a provider's future competitive significance is best measured by capacity, then that is the appropriate measure for determining market share. Clearly, AT&T/TCG and MCI WorldCom have enormous amounts of capacity in the Chicago market, as MCI has made clear (see Section A above). Finally, Ameritech's share of revenue in the dedicated traffic market is likely to be less than its share of facilities, for precisely the same reasons as those articulated in the case of special access.

### 2. Competitors are Winning the Majority of the Growth

When a market is moving from a protected monopoly environment to a competitive one, market share is often a misleading measure of competition. A market that was, in recent history, a monopoly, may well be much more concentrated than an equally competitive

[59] IXCs presumably have the same incentive to under-report their facilities that any competitive firm in any industry has to keep its strategy close to the vest: namely, firms do not want to tip off their competitors as to where their greatest efforts against their competitors are focused, in order to head off a targeted response. In addition, IXCs have a regulatory incentive to under-report, because the greater their presence, the stronger is the incumbent's case for forbearance, 271 relief, etc. IXCs have the greatest ability to under-report facilities that completely bypass Ameritech's facilities, because Ameritech has no direct means of knowing that such competitive facilities exist.

market without a regulated history. Market shares are "path-dependent;" i.e., they depend upon past market shares, even if the market is now highly competitive. An incumbent that prices competitively need not lose customers to competitors; if the incumbent prices so as to reflect the competitive threat, there is no incentive for their existing customers to move. Customers nonetheless receive the benefits of competition even if the market share does not change.

Hence, market shares tend to understate the degree of competition in markets undergoing deregulation, and tend to underestimate a competitors "future market significance," the criterion for appropriately measuring market share in the Merger Guidelines. For this reason, it is sometimes more instructive to examine the share of the incumbent in the *growth* of the market. For customers who are new to the market, there is no bias in favor of the incumbent that would be induced by inertia. Hence, growth in market share is more likely to represent the degree to which competitive alternatives are available and attractive. Moreover, if the growth in the market is substantial, firms that win a substantial share of growth will quickly hold a larger share of the overall market.

**Table 2:**
**Ameritech and CLEC Shares of Special Access Market Growth:**

| | 4Q96 – 1Q97 | 1Q97 – 4Q97 | 4Q97 – 1Q98 |
|---|---|---|---|
| Ameritech | 73.8% | 47.0% | 36.2% |
| CLECs | 26.2% | 53.0% | 63.8% |

Note: Between 4Q96 – 1Q97, the Chicago DS3 and DS1 equivalent markets contracted. The growth share numbers for this period represent the growth in DS1 lines. The other two periods are measured in DS1 equivalents.

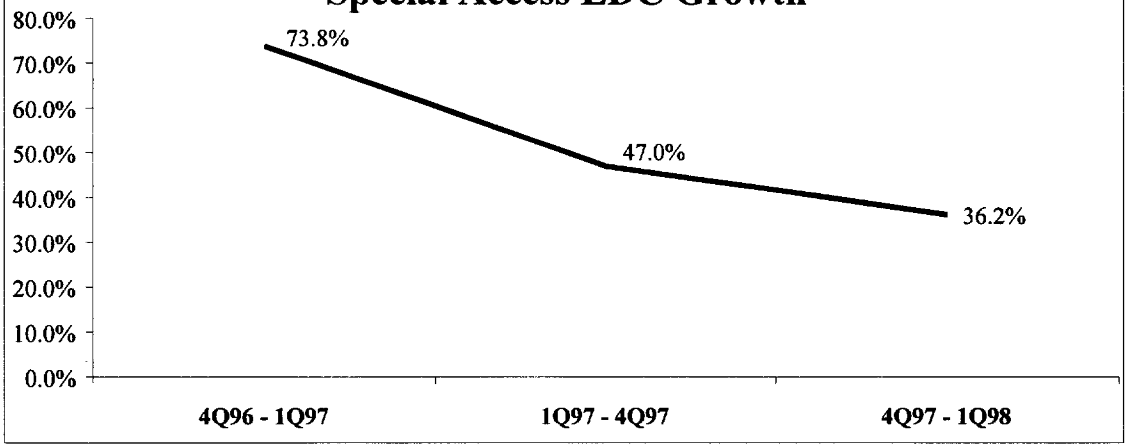
*Source: Quality Strategies, Ameritech Chicago HICAP Track Report, First Quarter 1998 (Exhibit 8).*

Table 2 demonstrates Ameritech's share of the growth of the special access market (share of growth figures are unavailable for transport because they are not collected by Quality Strategies). In the Chicago MSA, Ameritech captured only 36.2% of the growth in the market, on a DS1 equivalent basis, for growth between 4Q97 and 1Q98, which is the most recently available period. During this quarter, the special access market expanded by 6.7%. Overall, the special access market grew at a rate of 18.7% per year between

1Q97 and 1Q98. As shown in Figure 2, Ameritech's share of the growth market has plummeted in a period of less than two years.[60]

These figures are particularly important because the access market is growing so quickly in Chicago. In the one-year period 1Q97 to 1Q98, the number of DS1 equivalent lines in the Chicago MSA grew by 18.7%. At that rate of growth, the market will double in about four years. If competitors capturing the lion's share of the growth, starting from an already-substantial base, Ameritech's market importance will continue to diminish at a rapid rate.

**Figure 2: Ameritech Share of Chicago MSA Special Access LDC Growth**




Note: Between 4Q96 and 1Q97, the DS3 and DS1 equivalent markets contracted. The growth percentage for that period is measured in DS1s. The other periods are measured in DS1 equivalents.

The numbers speak for themselves. Ameritech is not at risk of losing its dominant position in the high-capacity market in Chicago; it has already lost it. Ameritech's market shares demonstrate that competitors are penetrating the growth market far more successfully than Ameritech is, and Ameritech is failing to keep its existing customers. Ameritech cannot be considered a dominant player under these circumstances. The success of the competitors further indicates that there are no significant barriers to entry in the provision of high-capacity access services, a critical determinant of market power. If entry is reasonably unimpeded, a provider cannot have market power, no matter what its market share.

60 Quality Strategies, *Ameritech Chicago HICAP Track Report* First Quarter 1997, Fourth Quarter 1997, and First Quarter 1998, (Exhibits 6, 7, and 8). Between 4Q96 and 1Q97, the number of DS3 lines and, thus, the number of DS1 equivalent lines actually decreased. For this period, we used the growth in DS1 numbers as a proxy for growth of the entire special access market.

## C. ALTERNATIVE PROVIDERS ARE IN POSITION TO INCREASE THEIR COMPETITIVE ACTIVITY

As I explained in Section II, a proper market power analysis considers not only the share of customers that are actually being served by the various providers in a market, but also examines indications that competitors and potential competitors are poised to increase their competitive activity. An examination of the extensive alternative provider fiber networks in Chicago and the collocation of Ameritech's competitors in Ameritech's wire centers reveals that Ameritech's competitors are poised to extend their competitive presence and maintain the momentum of their competitive activity.

### 1. Collocation

Because our measures of market share are likely to underestimate the importance of Ameritech's competitors in the market, it is useful to examine alternative measures of market importance that are likely to be at least as instructive about the competitiveness of the market. In this section we examine collocation as a measure of competitive importance in the provision of dedicated transport for switched access. In the next section, we examine the presence of competitors' fiber facilities as a measure of competition in the special access market.

When a competitor collocates in Ameritech's central office, it makes a financial investment to establish a facilities presence in the wire center. Collocation is a strong indication that the collocated provider's backbone interoffice network extends to this central office. In most cases, a CLEC would not collocate in a CO if it had not extended fiber to that wire center. Indeed, a competitor is considered to have "operational collocation" in a CO only if it has at least one customer that it serves via its collocated facilities in that CO. Hence, operational collocation in a central office is direct evidence of a competitor's existing, in-place facilities capable of providing dedicated transport for switched access there.

Exhibit 2 shows the Ameritech wire centers in the Chicago LATA, and indicates which are collocated by at least one competitor. It is apparent from examining the map that most central offices in areas that one would expect to have significant amounts of switched traffic are collocated. One would not necessarily expect competitors to provide dedicated transport for switched access in each and every central office in the LATA, because for central offices with low levels of switched traffic, common transport may be a more efficient alternative. In those wire centers, the fact that common transport is provided by Ameritech under regulated rates provides any necessary constraint on Ameritech's pricing with respect to dedicated transport for switched access. Ameritech is not seeking forbearance on common transport at this time.

Moreover, despite the fact that much switched traffic is typically dispersed among smaller central offices where common transport is likely to be the efficient choice, fully 69.1%[61] of all switched access minutes in the Chicago LATA are associated with wire centers in which there is at least one competitor with operational collocation at the CO. Examining the MSA specifically, 86.7% of switched access minutes of use in the city of Chicago are associated with wire centers that are collocated, and 62.9% of switched access minutes in the suburbs are associated with wire centers that are collocated.[62] This indicates that where there is a significant amount of switched traffic densely aggregated, competitors (many of whom are the IXCs themselves) have facilities in place to provide dedicated transport for switched access. This, together with the regulatory constraints on common transport prices, is sound evidence that Ameritech has no market power in the provision of dedicated transport for switched access.

### 2. Fiber Routes

Competitors have been upgrading and expanding their networks both by construction and acquisition. As I have discussed, MCI WorldCom/MFS and AT&T/TCG already have extensive fiber optic networks in place in Chicago-area markets, due largely to the acquisition of the networks of companies like MFS and TCG, who initially entered the market as CAPs. MCI WorldCom and AT&T/TCG are Ameritech's largest special access competitors and are Ameritech's largest special access customers.

To determine where competitors have fiber facilities offering special access service, Ameritech relied on reports produced by Quality Strategies Inc. The data compiled by Quality Strategies allowed Ameritech to produce partial maps of its largest competitors' fiber networks. As the attached maps show (see Exhibits 3 and 4), these competitive fiber networks are pervasive in those areas that generate most of the demand for Ameritech's special access services.

These maps do not reflect all of the competitive fiber already in the ground today. Quality Strategies developed fiber map information only on two competitors – AT&T and MCI WorldCom. None of the fiber known to have been put in place by other competitors, such as NextLink, is represented in these maps. Moreover, Quality Strategies only examined Chicago and its surrounding suburbs. Fiber outside of this area was not captured in their studies. Hence, these maps reflect only a subset of the actual fiber in place. Finally, Exhibit 3 differs slightly from Exhibit 4. The former exhibit is a consolidation of fiber maps prepared by Quality Strategies, showing AT&T and MCI WorldCom's fiber backbone networks. The latter exhibit is based on Quality Strategies' narratives of AT&T's and MCI WorldCom's facilities, as contained in the *Ameritech CAP/CLEC Chicago Network Description* report. Discrepancies between these reports arose when Quality Strategies had information on a carrier's facilities in a service area, but was uncertain as to the exact geographic location of the facilities. Therefore, the

61 Data provided by Ameritech.

62 Data provided by Ameritech.

geographic scope of AT&T and MCI WorldCom facilities in the map that describes participation by service area (Exhibit 4) is broader than that which graphs the carriers' fiber backbone networks (Exhibit 3). These exhibits therefore should not be taken as an exhaustive picture of competitive fiber, especially in the areas outside the Chicago MSA.

A visual comparison of the collocated wire centers and IXC fiber routes suggests a substantial overlap. Where the fiber maps do not extend to the central office, it is almost certain that the map is understating the ubiquity of the IXCs' fiber networks, for reasons I explained in Section IV.B. Moreover, the map makes clear that there are many wire centers traversed by competitive fiber where there is no collocation. In these serving areas, the competitor is apparently providing service by by-passing Ameritech's network entirely. In wire center serving areas traversed by competitive fiber, it is reasonable to assume that Ameritech's high-capacity revenues in that wire center are addressable within a short period of time by the competitor. Examining the high-capacity revenues in wire centers known to be traversed by competitive fiber (collocated or not), we find that 87.2% of Ameritech's total high-capacity revenues derive from these wire centers. Looked at from a line-count perspective, the wire centers traversed by competitive fiber account for 94.2% of Ameritech's special access LDCs on a DS1 equivalent basis.[63] Although these figures are almost certainly understated (due to our incomplete information on competitive fiber), they are nevertheless important measures of AT&T and MCI WorldCom's future competitive significance and, therefore, further demonstrate Ameritech's lack of market power in special access.

The installation of backbone fiber networks, or fiber rings, has become commonplace in the telecommunications market because of the tremendous amount of traffic fiber can carry, coupled with explosive demand for high-speed data services. The initial cost of the ring can vary significantly because of factors such as cable costs, equipment costs, structure costs, right-of-way costs, bandwidth, terrain, etc. However, given the enormous capacity of a fiber ring once constructed, the marginal cost of adding additional traffic on the ring itself is close to zero. In addition, the cost of attaching a customer to the ring is significantly less than the ring's initial construction cost. Bell Atlantic estimates that a competitor can reach a customer location within 2,000 feet of its backbone network for as low as $6,200 in a major city or urban area, and it can reach a customer location within one mile of its network in a suburban or rural area for about $24,000.[64] On behalf of U S WEST, Power Engineering estimates that a competitor can reach a customer location that

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63 Data provided by Ameritech.

64 Federal Communications Commission, *In the Matter of Petition of Bell Atlantic Telephone Companies for Forbearance from Regulation as Dominant Carriers in Delaware; Maryland;* Massachusetts; *New Hampshire; New Jersey; New York; Pennsylvania; Rhode Island; Washington, D.C.; Vermont; and Virginia*, Petition of Bell Atlantic for Forbearance, Docket No. CC 99-24, January 20, 1999 ("Bell Atlantic Petition"), Attachment B, p. 8.

is between 1,000 and 2,000 feet from its fiber route for approximately $40,000.[65] Although this is higher than Bell Atlantic's cost estimate, it remains well below the revenue that a CLEC can expect to capture when it connects to a customer location where customers purchase multiple DS1s or even one DS3. Based upon Ameritech's Zone 1 tariff information, the revenues from selling representative DS1 and DS3 circuits, purchased on 60-month term agreements, are approximately $3,500 and $47,500 per year respectively.[66] In any case, once the link is built, the initial cost is sunk and the marginal cost of serving that location is virtually zero.

## V. CONCLUSION

Ameritech is participating in a highly robust competitive environment in the high-capacity access market in Chicago. The significant erosion in Ameritech's market share and its weak share of growth, while not vital to demonstrate a lack of market power, certainly demonstrate the strong presence of effective competitors and the inability of Ameritech to compete vigorously under current constraints. Competitors, including behemoths such as AT&T-TCG and MCI WorldCom whose resources dwarf those of Ameritech, have established operational collocation – not just collocation agreements – in wire centers that produce 69.1%[67] of Ameritech's total switched access minutes of use in the Chicago LATA. Their fiber traverses wire centers accounting for at least 87.2% of Ameritech's high-capacity revenues in the LATA, and 94.2% of Ameritech's special access LDCs.[68] They have built out high-capacity networks densely in the downtown area and have extended tentacles throughout the Chicago areas where businesses congregate. Given the powerful body of evidence on market share, share of market growth, speed of growth of the market, the near-ubiquity of competitive fiber, extensive collocation, and financial might of the competitors, I conclude that Ameritech does not have market power in the high-capacity access market in the Chicago LATA. The constraints imposed on Ameritech in this environment have become outdated to the point of distorting Ameritech's ability to compete effectively and to leverage its own expertise to provide services that customers demand. The distortions imposed on competition by continued asymmetric regulation harm customers in Chicago by depriving them of the full benefits of vigorous competition. One does not have to place faith in the power of potential competition to confidently release Ameritech from the constraints of asymmetric regulation in the Chicago high-capacity market. Competition is already in full swing. When markets can function on their own, regulations can never protect customers as

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65 Federal Communications Commission, *In the Matter of Petition of U S WEST Telecommunications, Inc. for Forbearance from Regulation as Dominant Carriers in the Phoenix, Arizona MSA*, Petition of U S WEST Communications, Inc. for Forbearance, Docket No. 98-157, August 24, 1998, Attachment B, Appendix Data and Data Sources.

66 Assuming that representative DS1 and DS3 services include one local distribution channel ($112.50 and $3,000 per month) , two channel mileage terminations ($24.80 and $281 per month), and 10 miles of channel mileage ($13.84 and $40.00 per mile per month).

67 Data provided by Ameritech.

68 Data provided by Ameritech.

effectively as competition can. The best that regulators can do is get out of the way and let the providers serve customers as their customers and competitors dictate. The FCC should recognize that its work is done in Chicago and, in the interest of high-capacity access customers in Chicago, exercise its authority to forbear from any further asymmetric regulation of Ameritech in the provision of high-capacity access services in the Chicago LATA.

## APPENDIX I: DESCRIPTION OF THE SERVICES AT ISSUE IN THE REPORT

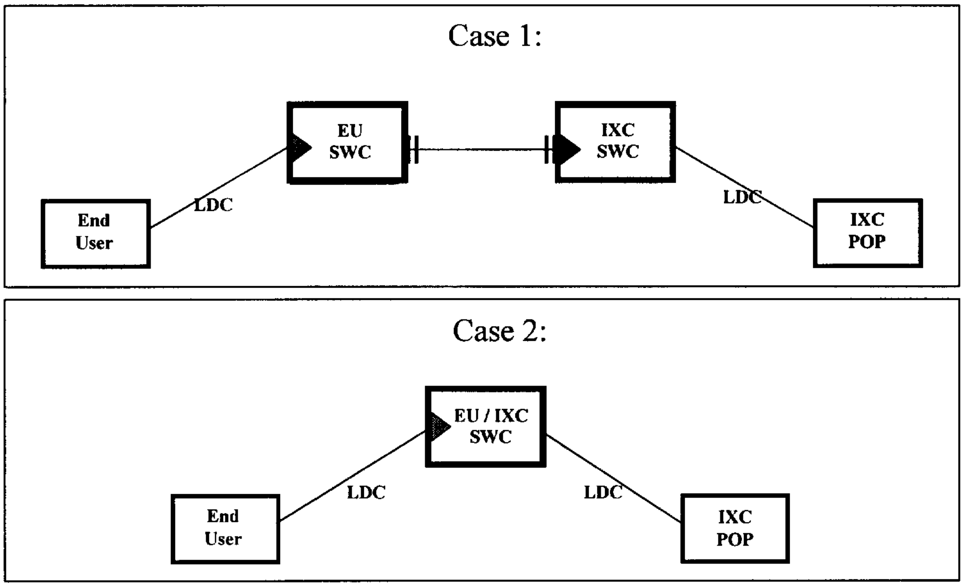
### A. SPECIAL ACCESS

Special access can be provisioned in a variety of ways. Special access provides the customer with a dedicated high-capacity connection, or pipe, from the customer's premises to the IXC's Point of Presence (POP). However, this pipe is not typically provisioned by a uniquely built facility routed directly from the customer's location to the POP. If Ameritech provides special access it is provisioned, as shown in Figure 1, through a series of connections. First, the customer premises are connected to the nearest serving wire center central office. This link is called a Local Distribution Channel ("LDC"). From there, the traffic is transported to the wire center serving the IXC's POP (if that happens to be located in a different wire center). From there the traffic is routed to the IXC's POP via another LDC. The series of connections from the end user's serving wire center (SWC)[69] to the IXC's POP is known as dedicated transport for special access. Hence, special access traffic may follow the same geographic path as switched access traffic, except that it does not use the LEC's public switched network (i.e., it does not go through the switch).

69 As used in this appendix, "Serving Wire Center" refers to an Ameritech wire center serving the end user, the interexchange carrier, or both.

**Figure 1**

Methods of Provisioning Special Access




LDC = Local Distribution Channel
EU SWC = Ameritech Wire Center Serving End User
IXC POP = Interexchange Carrier Point of Presence
IXC SWC = Ameritech Wire Center Serving Interexchange Carrier

In the Chicago market, alternative providers may compete with Ameritech for any segment of the pipe. That is, one competitor may provide the LDC serving the end user, another the interoffice segment, and yet another the LDC serving the IXC.

End-to-end special access services also can easily be self-supplied in the Chicago market. Some customers may find it economical to self-provide a direct end-to-end connection between themselves and the IXC POP by provisioning a pipe or wireless connection. In such cases, the special access may not traverse Ameritech's central office at all. Now that the big IXCs own the big CAPs, each IXC is powerfully positioned to self-supply access through its CAP, as I have described in the text.

Special access service comprises the elements described in Figure 1, Cases 1 and 2. The cases differ only in that, in Case 2, the customer premises and IXC POP share a common serving wire center.

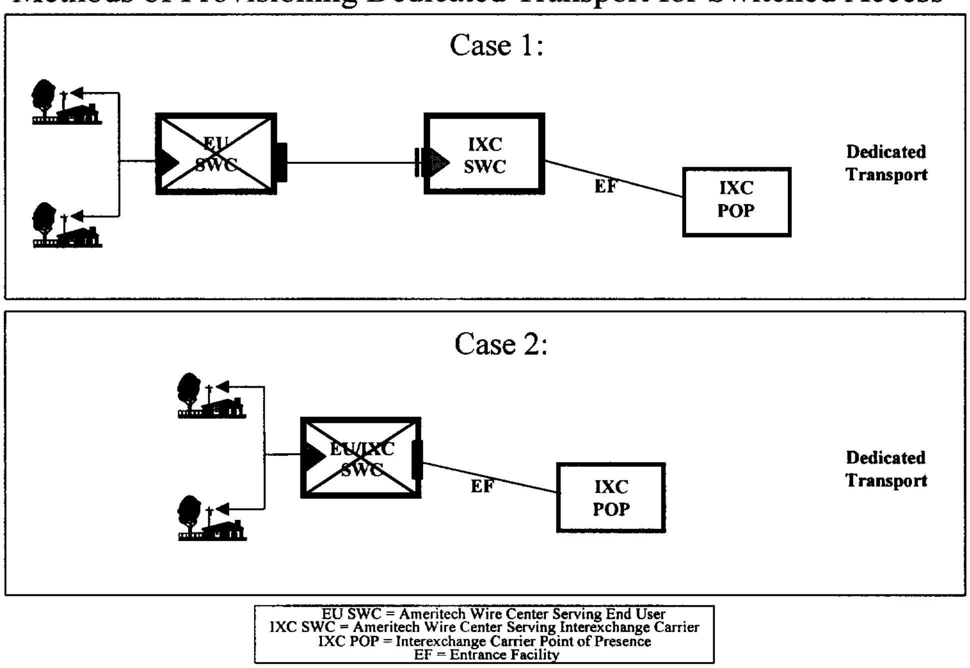
## B. Dedicated Transport for Switched Access

The second service for which Ameritech is seeking regulatory forbearance is dedicated transport for switched access traffic. When an end-use customer opts for switched access (rather than special access) to its long distance provider, the call is transported from the customer's premise to the LEC's serving wire center over the customer's local loop. The switch recognizes the call as a long-distance call that must be transported to the designated IXC's POP. At this point, the IXC must provision or arrange for transport of that call to its POP. This may be done in two ways. The IXC might build or lease dedicated facilities to transport its own and only its own traffic to its POP. This is called dedicated transport for switched access (See Figure 2). A comparison of Figures 1 and 2 shows that dedicated transport for special access and dedicated transport for switched access are identical functions that can be, and often are, provided over the same facilities.

In provisioning dedicated transport for switched access, the facility connecting the IXC serving wire center with the IXC POP is called an "Entrance Facility" ("EF"). Competitors can compete with Ameritech for this traffic on either an end-to-end or segment-by-segment basis. In fact, the presence of a collocated competitor in Ameritech's wire center indicates the presence of competitive transport facilities to the IXC's serving wire center.

**Figure 2**

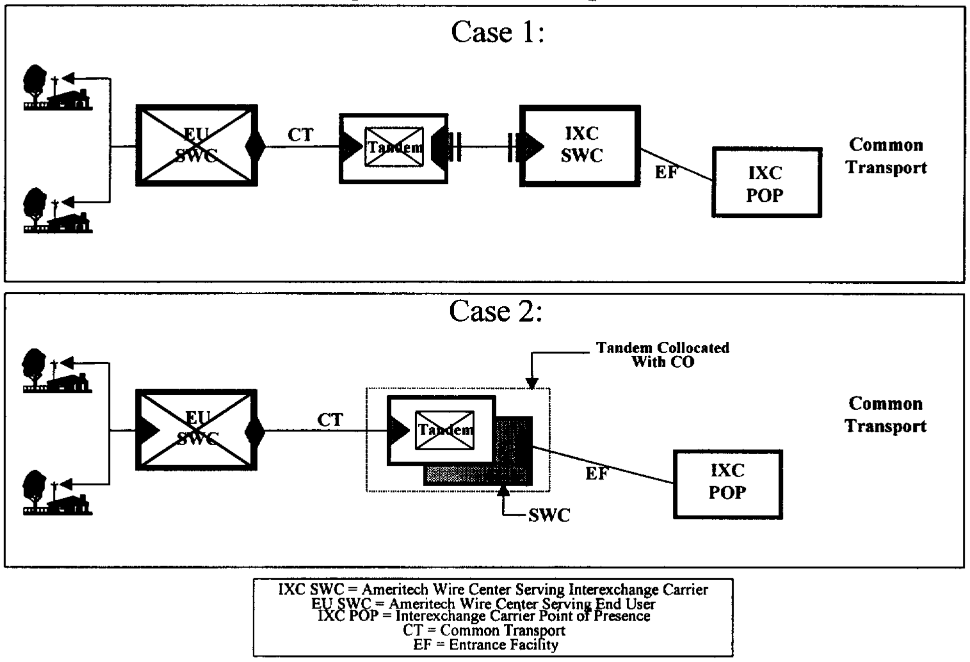
Methods of Provisioning Dedicated Transport for Switched Access




Alternatively, the IXC might pay the LEC to transport the traffic over facilities that are used by the LEC to transport many carriers' traffic, to a point of aggregation, such as a tandem switch. At that point, the IXC can aggregate its traffic from several wire centers, and from there transport it to its own POP via dedicated facilities. The portion of the transport from the end use customer's serving wire center to the LEC's tandem switch is called Common Transport (See Figure 3).

**Figure 3**

Methods of Provisioning Common Transport for Switched Access




Several factors distinguish dedicated transport from common transport. First, dedicated transport entails a fixed capacity supplied exclusively to the IXC for transport of its traffic between an end-user's serving wire center and the IXC's POP, whereas common transport is provisioned on a first-come, first-served basis, i.e. the capacity is shared (or common). Second, the rate structures of dedicated and common transport differ. Common transport is priced on a duration (per minute) and distance (per mile) sensitive basis, whereas the dedicated transport rate structure is not duration-sensitive and is distance-sensitive only to the extent that channel mileage is incurred between two central offices. Given this variation in rate structures, traffic volume plays a central role in an IXC's selection of transport. When the volume reaches a sufficient threshold, the IXC will typically select a dedicated facility from the end-user's serving wire-center to its POP. In contrast, among the wire centers where traffic volume fails to reach a sufficient threshold to justify a dedicated facility, the IXC first aggregates the traffic by transporting it to a centrally located tandem switch via a common transport facility and then hauls the aggregated traffic over a dedicated facility from the tandem switch to its POP. Figures 2 and 3 portray the differences between dedicated and common transport, as well as the various methods by which each category of transport are provisioned. Similar to special access, the primary difference between Cases 1 and 2 in each figure is that under Case 2, no transport is needed from the tandem to the IXC POP's serving wire center because they are in the same location. All methods of transport require a dedicated entrance facility from the wire center to the IXC's POP. In all figures, an X represents a switch.

## APPENDIX II: PRODUCT MARKET AND GEOGRAPHIC MARKET DEFINITION

Ameritech is seeking forbearance from regulation of two services in the Chicago LATA: special access service, and dedicated transport for switched access traffic. In order to assess whether Ameritech has market power in the provision of these services, it is necessary first to identify the relevant product and geographic markets for special access and dedicated transport for switched access. According to the *Merger Guidelines*:

> *A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a 'small but significant and nontransitory' increase in price, assuming the terms of sale of all other products are held constant.*[70]

In Section A of this appendix, I discuss product market definition in each of the relevant high-capacity access product markets. In Section B, I discuss the relevant geographic markets.

### A. PRODUCT MARKET

Special access services are purchased primarily by IXCs and by large telecommunications-intensive customers to obtain dedicated circuits to transport interLATA traffic between a customer's premises and an IXC's POP without traversing the LEC's switched network. In contrast, all traffic that an IXC receives through the LEC's switched network is known as Switched Access, and requires a per-minute-of-use payment from the IXC to the LEC. Avoiding the LEC's switched network permits the IXC to avoid the switched access fees and, therefore, permits the IXC to pass the savings on to the customer in the form of lower long-distance rates. Because special access traffic requires a separate, dedicated pipe from the customer's premises to the serving wire center (SWC), while switched access traffic is transported to the SWC over the same local loop that transports local switched traffic, only customers with a level of long-distance traffic that exceeds some threshold level will save enough money on long-distance rates to justify the additional fixed costs of the additional pipe.

Demand for special access therefore depends on the price of special access and the price of its nearest substitute, switched access. Control over whether to adopt switched or special access is exercised by the end-use customer. That is, the customer decides, on the

[70] *Merger Guidelines*, §1.1.0.

basis of relative prices and perhaps other factors, whether to transport its long-distance calls from its premises to the IXC's POP over switched or special-access arrangements.

The end-use customer who opts for switched access has no control over the means of transport of the traffic from its serving wire center to the IXC's POP. The relevant decision-maker in the case of transport is the IXC. That is, the IXC determines whether its switched traffic will be transported over common or dedicated facilities.

A careful examination of market definition would require an analysis of whether special access and dedicated transport for switched access are close substitutes in demand (where "close" is as defined by the Merger Guidelines). The chain of logic by which the two would be substitutes in demand is as follows: if the price of dedicated transport for switched access were to sustain a small but significant and non-transitory increase, this would induce some flight to common transport for switched access, which is presumably the closest substitute from the IXC's perspective to dedicated transport for switched access. If the flight to common transport would be enough to make the original price increase unprofitable, then common and dedicated transport are in the same product market. Now, suppose this is the case, and consider a small but significant non-transitory increase in the price of both common and dedicated transport for switched access. This price increase will, presumably, induce the IXCs to encourage (via price) their customers to change from switched access to special access. If the movement to special access is enough to render the price increase on transport unprofitable, then special access is in the same market as common and dedicated transport for switched access.

Proving the case that a firm lacks market power over a broadly defined product market is generally easier than proving the case for each more narrowly defined market sub-market. Moreover, it is clear that special access, dedicated transport for switched access, and common transport are substitutes in consumption because they are all means of providing the same basic functionality to the end user – namely, transport of traffic to the IXC's POP. Hence, a strong case certainly could be made that these services are in the same product market. Defining the marker more broadly in this way would render it easier to prove lack of dominance in the market. Instead, we have assumed that special access and dedicated transport for switched access represent separate product markets, and demonstrate that Ameritech lacks market power in each. Hence, our approach should be understood to be highly conservative in that we have set and met a higher criterion for establishing non-dominance.

The technology of the market does not permit the products to be easily analyzed separately in this way, however. As indicated in Appendix I, dedicated transport for switched access and dedicated transport for special access are identical functions provided over, literally, the same facilities in many cases. Hence, on any route, a provider of dedicated transport for special access can be and often would be providing dedicated transport for switched access traffic as well. While the two may or may not be very strong substitutes in demand, they are clearly extremely strong substitutes in supply. Indeed, the price charged by Ameritech for dedicated transport is the same whether the traffic being carried is switched or dedicated access traffic. Hence, for transport between any two points, the capacity of any provider to supply dedicated service is independent of whether the traffic being carried is switched or special access. As a result, any carrier that is "in the market" to provide dedicated transport for special access is "in the market" to provide dedicated transport for switched access, and vice versa. For these reasons, market shares would be difficult to assess separately for dedicated transport for switched access and dedicated traffic for special access, and no separately defined market share statistics are available. Market share statistics are available only for dedicated transport as a whole, not broken down by whether the traffic being transported is switched or special access.

This is not significantly problematic for us, however. The reason is that, recall, the Merger Guidelines recognize that for purposes of calculating market share, the providers in a market, and their supply to the market, should be determined on the basis that best reflects their future competitive significance. The future competitive significance of a provider of dedicated traffic is best measured on the basis of capacity or collocation, independent of whether the traffic being carried is switched or special. While we do not have market shares of capacity, our market share for dedicated transport does include both switched and special access customers, which better reflects competitors' capacity to provide either service than a market share of one or the other alone.

## B. GEOGRAPHIC MARKET

The logic of defining the geographic market proceeds as follows: suppose Ameritech has a given fiber backbone in a particular location. That fiber backbone is providing special access to customer *A* at its place of business. If Ameritech were to raise its price of providing customer *A* with access over that fiber backbone, would *A* be willing to connect to the fiber backbone of another provider? That would depend on where the competitor's fiber is, and how costly it is to connect to it. Suppose that for a 5 percent price increase, *A* would be willing to switch to any competitor (and pay the costs of building out to the backbone) whose backbone is within X feet of *A*'s building. Then we could say that the geographic market is X feet from customer *A*'s building. If the service of the competitor is identical to that of Ameritech, then X feet is determined by how many feet *A* can build out such that the build-out costs plus any switching costs amount to no more than 5 percent of the original price.

A literal interpretation of this approach would require defining multitudes of geographic markets within the Chicago LATA, if Ameritech can charge a different price to each customer. It is not administratively feasible for Ameritech literally to charge different prices to each customer, but because Ameritech would be granted this theoretical degree of flexibility were the FCC to grant forbearance, a highly conservative approach would permit this possibility. Hence, while the complexity of networks – their architecture, construction, and technology – makes adopting this narrow approach to geographic market definition difficult, it is possible to preserve the principles of the methodology and simplify significantly by looking, instead, at geographic areas with fairly homogenous competitive conditions and then carefully analyzing the geographic location of competitive fiber.

FCC precedent supports this approach to defining the geographic market. For example, in the 1995 *Second Further Notice* the FCC suggested the following: "[t]he relevant geographic market must be narrow enough to only encompass competing access services for the same set of customers, yet be broad enough to be administratively workable."[71] Likewise in the FCC Order *In the Matter of AT&T Corp. to be Declared Non-Dominant for International Service* (1996), the FCC did not make a route-by-route analysis of international telephone calls; instead, it treated international services on a global basis. It examined to percentage of international traffic on concentrated routes (AT&T was the sole facilities-based supplier) and found it to be a "*de minimis*" share. The Order explains that the economic costs of regulation outweighed the benefits of protecting this *de minimis* traffic. Based on the characteristics of the market described in this affidavit and the methodology established by the FCC, a LATA-wide market definition is an appropriate delineation of the area in which high-capacity services are generally present. It establishes a geographic area that is large enough to be administratively workable and reflects the geographic area definition that the network configuration of suppliers has historically been based on. Following the logic of the FCC, competition does not have to be uniform or literally ubiquitous in every narrowly defined geographic market for a carrier to be non-dominant. A more appropriate criterion is whether the competition is present in a significant share of the areas where there is demand for the service.

71 *In the Matter of Price Cap Performance Review for Local Exchange Carriers*, Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, 11 FCC Rcd 858, 861-862 (1995).

## APPENDIX III: QUALIFICATIONS OF DR. DEBRA J. ARON

My name is Debra J. Aron. I am the Director of the Evanston offices of LECG, Inc., a position I have held since July 1995. LECG, Inc. is an economics and finance consulting firm, providing economic expertise for litigation, regulatory proceedings, and business strategy. I received a Ph.D. in economics from the University of Chicago in 1985, where my honors included a Milton Friedman Fund fellowship, a Pew Foundation teaching fellowship, and a Center for the Study of the Economy and the State dissertation fellowship. I was an Assistant Professor of Managerial Economics and Decision Sciences from 1985 to 1992 at the J. L. Kellogg Graduate School of Management, Northwestern University, and a Visiting Assistant Professor of Managerial Economics and Decision Sciences at the Kellogg School from 1993-1995. I was named a National Fellow of the Hoover Institution, a think tank at Stanford University, for the academic year 1992-1993, where I studied innovation and product proliferation in multiproduct firms. Concurrent with my position at Northwestern University, I also held the position of Faculty Research Fellow with the National Bureau of Economic Research from 1987-1990.

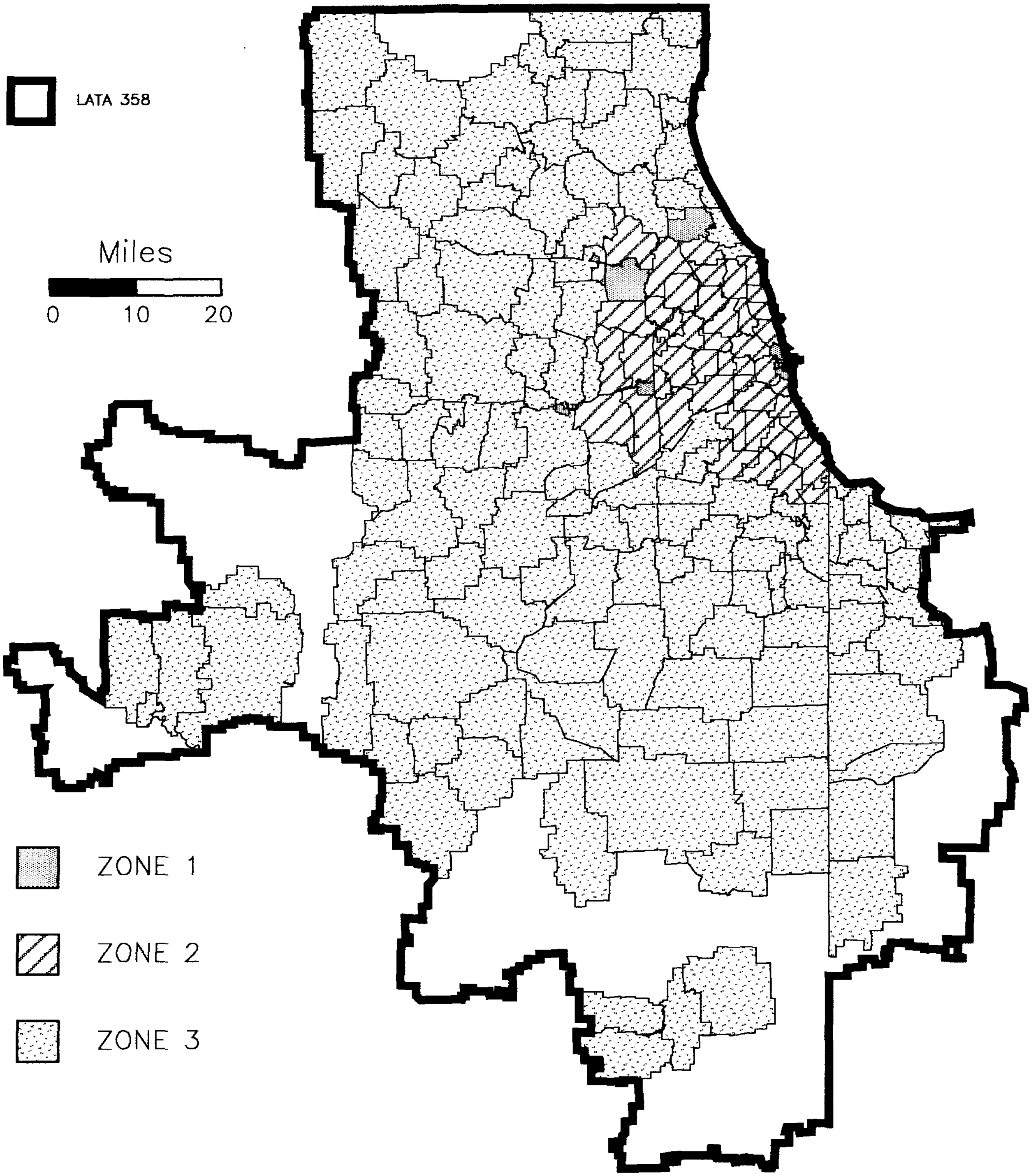
At the Kellogg School, I have taught M.B.A. and Ph.D. courses in managerial economics, information economics, and the economics and strategy of pricing. I am a member of the American Economic Association and the Econometric Society, and an Associate member of the American Bar Association. My research focuses on multiproduct firms, innovation, incentives, and pricing, and I have published articles on these subjects in several leading academic journals, including the *American Economic Review*, the *RAND Journal of Economics*, and the *Journal of Law, Economics, and Organization.*

I have consulted on numerous occasions to the telecommunications industry on strategic and efficient pricing. I have testified in several states regarding the proper interpretation of Long Run Incremental Cost and its role in pricing; the economic interpretation of pricing and costing standards in the Telecommunications Act of 1996; limitations of liability in telecommunications; Universal Service; and proper pricing for mutual compensation for call termination. I have also submitted affidavits to the Federal Communications Commission analyzing the merits of Ameritech Michigan's application for authorization under Section 271 of the Telecommunications Act to serve the in-region interLATA market, CC Docket No. 97-137, and explaining proper economic principles for recovering the costs of permanent local number portability, CC Docket No. 95-116. I have conducted analyses of mergers in other industries under the U.S. Merger Guidelines. In addition, I have consulted in other industries regarding potential anticompetitive effects of bundled pricing and monopoly leveraging, market definition, and entry conditions, among other antitrust issues, as well as matters related to employee compensation and contracts, and demand estimation. In 1979 and 1980, I worked as a Staff Economist at the Civil Aeronautics Board studying price deregulation of the airline industry.

# Exhibit 1:

## Ameritech Wire Center Service Areas By Rate Zone In Chicago LATA 358

## EXHIBIT 1: AMERITECH WIRE CENTER SERVICE AREAS BY RATE ZONE IN CHICAGO LATA 358




*SOURCE: DATA PROVIDED BY AMERITECH*

ZONE2A